SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1915.

No. 707.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

vs.

SARGENT LAND COMPANY.

No. 708.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

vs.

SUTTON LAND COMPANY.

No. 709.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

vs.

KEARSARGE LAND COMPANY.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

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1 In the District Court of the United States for the District of Minnesota, Third Division.

Sargent Land Company, a corporation, Plaintiff,
No. 715. vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

Sutton Land Company, a corporation, Plaintiff,
No. 716. vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

Kearsarge Land Company, a corporation, Plaintiff,
No. 717. vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

Pleas before the Honorable, the Judges of the United States District Court for the District of Minnesota.

Be It Remembered, that on the 15th day of April, A. D. 1913, each of the plaintiffs in the above entitled action filed in the office of the Clerk of said Court its complaint, which complaints are, respectively, in the words and figures following, to-wit:

2 (Complaint of Sargent Land Company.)

Sargent Land Company, a corporation, Plaintiff,
vs.
Fred Von Baumbach, Collector of Internal Revenue, Defendant.

The plaintiff, complaining of the defendant above named, alleges:

1. The plaintiff is, and since the 20th day of February, 1906, has been, a corporation having a capital stock, duly organized and existing under the laws of the state of Minnesota, having its principal office in the city of Minneapolis in said state and, during all of said time, has been and is an inhabitant of the District of Minnesota, and of the Fourth Division of said district.

2. The defendant, on the 27th day of February, 1913, and for a long period prior thereto, was, has been since, and now is, the Collector of Internal Revenue of the United States for

the District of Minnesota, duly commissioned as such collector pursuant to the laws of the United States, and is an inhabitant of the District of Minnesota and of the Third Division thereof.

3. The plaintiff was organized as a corporation as aforesaid, under the laws of the state of Minnesota, by the execution, filing and publication of its Articles of Incorporation, a copy of which, marked Exhibit "A", is hereto attached, and is hereby referred to and made a part of this complaint.

3 The plaintiff was so organized for the primary purposes of receiving, and uniting in one ownership, the title to certain lands, until then held by its numerous stockholders in individual ownership, in proportions varying from one-fourth (1/4) to one one-hundred-and-eighth (1/108) thereof, and of liquidating and converting the same into money and distributing the proceeds thereof to said various owners in proportion to their former respective holdings in said lands. After its incorporation as aforesaid, the plaintiff received from its stockholders, and has ever since been the owner of, the said lands, subject to the rights of the vendees of the iron ore therein, as hereinafter alleged. The plaintiff corporation was not organized for profit, or with a view to carrying on or doing business; and, at no time since its organization as aforesaid, has the plaintiff carried on or done business of any kind, either for profit or otherwise; and the plaintiff is not, and never has been, a corporation subject to assessment for, or liable to pay to the United States, a special excise tax under the Act of Congress of August 5, 1909, or any other law.

4. At the time of the incorporation of the plaintiff, the only substantial value in its said lands consisted in deposits of iron ore thereon, and no substantial value therein has since developed or now exists. Prior to the incorporation of plaintiff, the iron ore upon portions of said land had been sold by the individual owners thereof, at and for a fixed and stated price per ton, and said lands were conveyed to and acquired by the plaintiff subject to the contracts of such sales, and no other sales of any ore thereon have been made except a similar sale made by this plaintiff January 2nd, 1907. The income of the plaintiff during the years 1909, 1910 and 1911 was derived almost exclusively from payments made under said con-
4 tracts of sale of iron ore, and no part of said income was derived from the carrying on or doing of any business.

5. The value of said iron ore so sold as aforesaid was fixed by said contracts, and, irrespective of any fluctuations in the market value thereof in the hands of the vendees of said ore or

their successors in interest therein, the value of said ores to the plaintiff is not, and can never be, other or greater than the sum named in its contracts of sale of said ore, and there has been, and can be, no increment in value or any profit as respects the plaintiff in said ores or lands.

6. On the 28th of December, 1909, the plaintiff duly amended its said Articles of Incorporation in the manner provided by the laws of the state of Minnesota, in order more clearly to set forth the original purposes and intentions of the incorporators, so that Article I thereof was changed from the form in which it was originally adopted as set forth in Exhibit "A", and the purposes and powers of the plaintiff were limited, and became as follows, to-wit:

"The general purpose of the corporation is to unite in one ownership the undivided fractional interests of its various stockholders in lands, tenements and hereditaments, and to own such property, and, for the convenience of its stockholders, to receive, and distribute among them, the proceeds of any disposition of such property at such times, in such amounts, and in such manner, as the board of directors may determine."

The purposes and powers of the plaintiff have since been, and now are, restricted by said amendment as aforesaid, and the plaintiff, since the date last named, has not been authorized to carry on or do business within the meaning of said Act of Congress of August 5, 1909.

5 7. After the approval of said Act of August 5, 1909, the defendant, as such collector as aforesaid, transmitted to plaintiff printed forms prepared under the direction of the United States Commissioner of Internal Revenue for the making of a return by plaintiff of its income for the year 1909, as required by said Act. Plaintiff forthwith notified the defendant that it was not, and during the year 1909 had not been, carrying on or doing any business; that it had derived no income whatsoever from carrying on or doing business during said year; that it was not a corporation organized for profit, and was not subject to the provisions of said Act of August 5th, and was not liable to pay the excise tax therein provided for.

Thereafter, during a long period, correspondence and negotiations relative to the liability of plaintiff to make return of income under said Act of August 5th was conducted between the plaintiff and the defendant acting under the instructions

of the United States Commissioner of Internal Revenue, which correspondence and negotiations were finally concluded in the month of September, 1912, by the decision of said Commissioner that the plaintiff was subject to the provisions of said Act of August 5, 1909, and liable to pay the excise tax provided for by said Act. Awaiting such decision, and solely by reason of the delay of said Commissioner in arriving at and announcing the same, plaintiff refrained from preparing and filing its returns of income required by said Act until the dates hereinafter mentioned.

8. On or about the 26th day of September, 1912, in pursuance of said decision of said Commissioner, the defendant, as such collector as aforesaid, demanded of the plaintiff the making and filing by it, in the office of said collector, of a return, in the form prescribed by the Commissioner, of the net
6 income of the plaintiff for the years 1910 and 1911, and threatened the plaintiff with the imposition of the penalties prescribed by said Act of Congress of August 5, 1909, in case of non-compliance with said demand. Pursuant thereto, but under protest, nevertheless, that it did not come within the purview of said Act of Congress, that it was not a corporation organized for profit, and that it was not carrying on or doing business during said years, and moved thereto solely by the threat of said penalties, and under the duress thereof, the plaintiff on or about the 23rd day of October, 1912, filed with the defendant true and accurate returns of its income for said years of 1910 and 1911, respectively. During each of said years there had occurred an actual depreciation in value of the property and capital assets of the plaintiff, and each of said returns showed such depreciation of the property of the plaintiff during the year therein referred to, and other deductions, as authorized by the law, in an aggregate amount in excess of the gross income of the plaintiff for such year.

9. Thereafter, on or about December 20, 1912, the defendant, as such collector, in like manner as aforesaid, and with a similar threat of the imposition of the penalties of said Act of Congress in case of non-compliance by plaintiff with said demand, demanded from, and required of, plaintiff that it make and file with the defendant, as such collector, a return of its income for the year 1909. Pursuant thereto, the plaintiff made and filed with the defendant, in the manner required by law, on or about Jaunary 14, 1913, a return of its income for said year 1909, which showed a depreciation in the property and capital assets of the plaintiff, and other deductions authorized by law, in an amount in excess of the gross income of the plaintiff for said year. Said depreciation actually occurred

and said other deductions were actually paid out by
7 plaintiff during said year. Said return was so made
and filed under protest, however, that plaintiff was not a corporation organized for profit, that it was not carrying on or doing business during said year 1909, and that it was not a corporation falling within the purview of said Act of Congress.

10. Notwithstanding the exemption of plaintiff from liability to pay any excise tax under said Act of Congress, and notwithstanding the depreciation in the value of its property and the deductions allowed by law during each of said years, the Commissioner of Internal Revenue of the United States assessed against the plaintiff a tax amounting to $2663.60, as a corporation tax for the year 1909 under the internal revenue laws of the United States, and, in addition thereto, as a penalty for the alleged wrongful delay of the plaintiff in making and filing its return for said year, the sum of $1331.80, making a total of $3995.40; and said Commissioner assessed against the plaintiff, for the year 1910, under said laws, a tax of $3847.34, and, in addition thereto, as a penalty for the alleged wrongful delay of the plaintiff in making and filing its return for said year, the sum of $1923.67, making a total of $5771.01; and for the year 1911, said Commissioner assessed a similar tax under said laws in the sum of $4916.20, and, in addition thereto, as a penalty for the alleged wrongful delay of plaintiff in making and filing its return for said year, the sum of $2458.10, making a total of $7274.30.

On the 25th of January, 1913, the defendant, as such collector as aforesaid, notified the plaintiff of each of such assessments and demanded payment of said sums on or before the 6th day of February, 1913, and threatened, unless said
sums were paid on or before said last named date, to
8 collect the same by distraint and sale of plaintiff's property, together with the penalties and interest in such case collectible under said law.

11. After the making of said demands by the defendant, the plaintiff duly made and filed with the defendant, in the form and manner provided by the law and in accordance with the practice in such case prescribed, a claim for abatement of said taxes so assessed by said Commissioner for each of said years, upon the grounds that the plaintiff was not subject to such tax and that the same was illegally assessed. Said claims were duly received and considered by said Commissioner, and, on the 15th day of February, 1913, were, and each of them was, rejected. Thereafter, on the 18th day of February, 1913, the

defendant, as such collector as aforesaid, demanded from plaintiff the payment of said tax for each of said years on or before ten days, and threatened, in case of non-compliance therewith, to proceed to collect the same by distraint and sale of plaintiff's property, with penalties and interest as specified in the law.

12. For its first cause of action, the plaintiff further alleges that, pursuant to the demand therefor, and moved thereto by said threat of the defendant, and under the duress thereof, it paid to the defendant, on or about the 28th day of February, 1913, for and on account of said tax for the year 1909 and the addition thereto, the sum of $3995.40; that plaintiff had no net income during said year, and that said tax was illegally assessed and unauthorized by law, for the reasons hereinbefore stated, as defendant was informed and well knew prior to demanding and receiving the same; and the requirement of payment thereof by the defendant and the receipt thereof by him were illegal and wrongful; that thereafter, and prior to the commencement of this action, the plaintiff duly made
9 and filed with the defendant its claim for the refunding of said payment and a demand for the refundment thereof, which claim and demand were rejected and refused; there is now due and owing to the plaintiff, from and by the defendant, the sum of $3995.40, with interest thereon at the rate of six per centum per annum from February 28, 1913.

13. For its second cause of action herein, the plaintiff hereby refers to and re-alleges each and every of the foregoing paragraphs numbered 1 to 11, both inclusive, and further alleges that, pursuant to the demand therefor, and moved thereto by said threat of the defendant, and under the duress thereof, it paid to the defendant, on or about the 28th day of February, 1913, for and on account of said tax for the year 1910 and the addition thereto, the sum of $5771.01; that plaintiff had no net income during said year, and that said tax was illegally assessed and unauthorized by law, for the reasons hereinbefore stated, as defendant was informed and well knew prior to demanding and receiving the same, and the requirement of payment thereof by the defendant and the receipt thereof by him were illegal and wrongful; that thereafter, and prior to the commencement of this action, the plaintiff duly made and filed with the defendant its claim for the refunding of said payment and a demand for the refundment thereof, which claim and demand were rejected and refused; there is now due and owing to the plaintiff, from and by the defendant, the sum of $5771.01, with interest thereon at the rate of six per centum per annum from February 28, 1913.

14. For its third cause of action herein, the plaintiff hereby refers to and re-alleges each and every of the foregoing paragraphs numbered 1 to 11, both inclusive, and further
10 alleges that, pursuant to the demand therefor and moved thereto by said threat of the defendant, and under the duress thereof, it paid to the defendant, on or about the 28th day of February, 1913, for and on account of said tax for the year 1911 and the addition thereto, the sum of $7374.30; that plaintiff had no net income during said year, and that said tax was illegally assessed and unauthorized by law, for the reasons hereinbefore stated, as defendant was informed and well knew prior to demanding and receiving the same, and the requirement of payment thereof by the defendant and the receipt thereof by him were illegal and wrongful; that thereafter, and prior to the commencement of this action, the plaintiff duly made and filed with the defendant its claim for the refunding of said payment and a demand for the refundment thereof, which claim and demand were rejected and refused; there is now due and owing to the plaintiff from and by the defendant the sum of $7374.30, with interest thereon at the rate of six per centum per annum from February 28, 1913.

15. This case arises under the laws of the United States providing for internal revenue and this court has jurisdiction thereof.

Wherefore, plaintiff demands judgment against the defendant for the sum of seventeen thousand one hundred and forty and 71/100 ($17,140.71) dollars, with interest thereon at the rate of six per centum per annum from February 28, 1913, together with its costs and disbursements herein.

FRED B. SNYDER,
EDWARD C. GALE,
Attorneys for plaintiff, 810 Security Bank Bldg., Minneapolis, Minn.

John R. Van Derlip,
Of Counsel.

11 Exhibit "A."

Articles of Incorporation
of
Sargent Land Company.

We, the undersigned, for the purpose of forming a corporation under and pursuant to the provisions of Title 2 of Chapter 34, General Statutes of Minnesota 1894, and the acts amendatory thereof, do hereby associate ourselves as a body corporate, and do hereby adopt the following Articles of Incorporation:

Article I.

The name of this corporation shall be the "Sargent Land Company".

The general nature of its business shall be the buying, owning, exploring and developing, leasing, improving, selling and dealing in, lands, tenements and hereditaments, and the doing of all things necessary or incidental to the things above specified.

The principal place of transacting said business shall be at the city of Minneapolis in Hennepin County, Minnesota.

Article II.

The time for the commencement of this corporation shall be the twentieth day of February, A. D. 1906, and the period of continuance of this corporation shall be thirty (30) years.

Article III.

The amount of the capital stock of this corporation shall be One Hundred and Eight Thousand Dollars ($108,000), which shall be paid in, in money or property, in such manner and at such times as the Board of Directors may from time to time direct.

Article IV.

The highest amount of indebtedness or liability to which this corporation shall at any time be subject shall be the sum of One Hundred Thousand Dollars ($100,000).

Article V.

The names and places of residence of the persons forming this association for incorporation shall be John M. Longyear, of Marquette County, Michigan, Russell M. Bennett of Deephaven, Minnesota, Alfred F. Pillsbury, Fred B. Snyder and Carleton C. Pillsbury, all of Minneapolis, Minnesota.

Article VI.

The names of the first Board of Directors of said corporation are John M. Longyear, Russell M. Bennett, Edmund J. Longyear, Norman C. Richardson, Helen H. Bennett, Alfred F. Pillsbury, Charles S. Pillsbury, Fred B. Snyder, Carleton C. Pillsbury and Frank H. Carleton.

The first president shall be the said Charles S. Pillsbury. The first vice-president shall be John S. Pillsbury. The first secretary and treasurer shall be the said Russell M. Bennett.

12 The government of this corporation and the management of its affairs shall be vested in a board of ten directors and in a president, vice-president, secretary and treasurer, and such other officers and agents as may be from time to time appointed by the Board of Directors. Said directors and officers above named shall hold their respective offices until the first Tuesday of December, 1906, at which time, and on every succeeding first Tuesday of December thereafter, a board of ten directors shall be elected by the stockholders of said corporation, at an annual meeting of said stockholders to be held at the office of the corporation in the city of Minneapolis, or such other place as the board of directors may direct. Immediately after the election of the directors, or as soon thereafter as practicable, the directors shall meet and elect from their number or from the stockholders of the corporation, a president, vice-president, secretary and treasurer. Any member of the board of directors or any stockholder of the corporation may fill any two of said offices except that of president and vice-president, which offices shall not be filled by the same person. The directors and officers of this corporation shall hold their respective offices until their successors have been duly elected and shall enter upon their duties. In case of a vacancy in the board of directors on account of death, resignation or removal, a special meeting of the stockholders shall be called within forty-five (45) days thereafter and a new director elected to fill such vacancy in the manner hereinafter provided. In case of a vacancy in the office of president, vice-president, secretary or treasurer, caused by death, resignation or removal, the directors of said corporation, when the board of directors is filled as hereinabove provided, shall fill such vacancy. Regular and special meetings of the directors and stockholders may be held at such times and under such rules as may be prescribed by the by-laws of such corporation, but the first meetings of the Board of Directors and the stockholders of said corporation shall be held at the office of the corporation in the city of Minneapolis, Minnesota, on the second Tuesday of May, A. D. 1906, at ten and eleven o'clock in the forenoon respectively. Any director may be represented at any meeting of the Board of Directors by proxy if the stockholders of this corporation shall authorize such representation by by-law.

Article VII.

The capital stock of this corporation shall be divided into two thousand one hundred and sixty (2160) shares of fifty dollars ($50) each.

Article VIII.

No sale, assignment, transfer, hypothecation, pledge or other disposition of any stock in this corporation, shall be valid or effectual for any purpose, until there has first been endorsed upon the stock certificate to be affected by such sale, assignment, transfer, hypothecation, pledge or other disposition, the approval or consent of a majority of the Board of Directors of such corporation, sitting as a Board, to such sale, assignment, transfer, hypothecation, pledge or other disposition.

Article IX.

No mining lease or any interest therein owned by the corporation shall ever be hypothecated, sold, assigned or transferred, nor shall any real estate or any interest therein owned by this corporation, ever be mortgaged, sold, conveyed or leased for a period longer than one year, except upon the affirmative vote of the holders of seventy-five per cent. (75%) of the
13 shares of the capital stock of the corporation actually issued and outstanding, given at a regular [o-] special meeting of the stockholders.

Article X.

The title to the properties belonging to this corporation having been, prior to the transfer thereof to the corporation, vested in various persons owning, respectively, different undivided interests therein, and such owners having been, at the time of such transfer to the corporation, divided into two general classes, to-wit: the heirs at law, assigns and devisees of George A. Pillsbury and Margaret S. Pillsbury, his wife, Charles A. Pillsbury and Mary A. Pillsbury, his wife, and John S. Pillsbury, all deceased, constituting the class known as "The Pillsbury Heirs," who owned collectively an equal one-half part of all said properties, and Russell M. Bennett and John M. Longyear, constituting the other of said classes, who owned as tenants in common the other undivided one-half of all said properties; and this corporation having been formed, by mutual agreement of all said owners of both classes, for the more convenient handling, improvement, development and disposition of said properties, and it being the desire and intention of all said owners that an equal voice, in all matters relative to said properties, shall remain, and be maintained in the future, in said two classes:

It is hereby established as the perpetual and undeviating rule of this corporation that one-half of the entire board of directors of this corporation shall always be nominated by, and elected to represent, each of said two classes of former owners,

so that, as long as the whole number of directors shall be ten, five directors, and five only, shall be chosen by the stockholders of this corporation from the nominees of "The Pillsbury Heirs" constituting one class, and five directors, and five only, shall be chosen by such stockholders from nominees of said Bennett and said Longyear constituting the other class.

In case a vacancy shall occur in said board of directors, such vacancy shall be filled by a nominee of the class by which the director whose retirement caused such vacancy was nominated; and until this article shall be altered or abrogated by the vote of the stockholders of this corporation, as hereinafter provided, the equal division, numerically, of said board of directors, shall be strictly maintained, so that said "Pillsbury Heirs" and their successors in interest shall always be represented upon the board of directors of this corporation by one-half of the full authorized number of directors, and said Bennett and Longyear, and their successors in interest, shall always be represented upon said Board by one-half of the full authorized number of directors, and no amendment of these Articles of Incorporation shall be made changing the number of directors, except to an even number.

Article XI.

Article X of these Articles cannot be altered, amended or abrogated, except by the vote of ninety (90) per cent. of the shares of the capital stock of this corporation actually issued and outstanding, nor can any other article be altered, amended or abrogated, except by the vote of seventy-five (75) per cent. of the shares of the capital stock of this corporation, actually issued and outstanding, the vote in every case to be taken at a regular meeting of the stockholders, or at a special meeting of the stockholders called for that purpose.

14 Article XII.

Articles VIII and X and XI of the Articles of Incorporation shall be printed in full upon and as a part of every certificate of stock issued by this corporation.

Article XIII.

No by-law of this corporation embodying the provisions of Article X of these Articles of Incorporation shall be altered, amended or abrogated except by the vote of ninety (90) per cent. of the shares of the capital stock of this corporation actually issued and outstanding, [not] can any other by-law be altered or amended except by the affirmative vote of seventy-

five (75) per cent. of the capital stock of this corporation, actually issued and outstanding, the vote in every case to be taken at a regular meeting of the stockholders, or at a special meeting of the stockholders called for that purpose.

In Witness Whereof, we have hereunto set our hands and seals this 26th day of January, A. D. 1906.

In presence of
J. E. Sherman
Emily McNulty
As to John M. Longyear.

Harry E. Coleman
Clara B. Martin
As to all other signers.

(Seal) RUSSELL M. BENNETT
(Seal) JOHN M. LONGYEAR
(Seal) ALFRED F. PILLSBURY,
FRED B. SNYDER
(Seal) CARLETON C. PILLSBURY

State of Michigan,
County of Marquette—ss.

On the 26th day of January, A. D. 1906, before me, a notary public within and for said county, personally appeared John M. Longyear, to me known to be the person mentioned in and who executed the foregoing instrument, and acknowledged that he executed the same as his free act and deed.

(Seal) JAMES E. SHERMAN,
Notary Public, Marquette County, Mich.

State of Minnesota,
County of Hennepin—ss.

On this 9th day of February, A. D. 1906, before me, a notary public within and for said county, personally appeared Russell M. Bennett, Alfred F. Pillsbury, Fred B. Snyder and Carleton C. Pillsbury, to me known to be the persons mentioned in and who executed the foregoing instrument, and acknowledged that they executed the same as their free act and deed.

(Seal) HARVEY E. COLEMAN,
Notary Public, Hennepin County, Minn.

My commission expires May 1st, 1912.

15 State of Minnesota,
County of Hennepin—ss.

Russell M. Bennett being first duly sworn upon his oath says that he is the Secretary and Treasurer of Sargent Land Company, plaintiff in the foregoing and within entitled action; that he has heard read the foregoing complaint, and that the same is true of his own knowledge, except as to those matters therein stated on information and belief and as to such matters he believes it to be true.

RUSSELL M. BENNETT.

Subscribed and sworn to before me this 14th day of April, A. D. 1913.

EDW. C. GALE,
Notary Public, Hennepin County, Minnesota.

My commission expires March 11th, 1914.

(Notarial Seal)

Endorsed: Filed in the District Court on April 15, 1913.

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16 (Complaint of Sutton Land Company.)

Sutton Land Company, a corporation, Plaintiff,
vs.
Fred Von Baumbach, Collector of Internal Revenue, Defendant.

The plaintiff, complaining of the defendant above named alleges:

1. The plaintiff is, and since the 20th day of February, 1906, has been, a corporation having a capital stock, duly organized and existing under the laws of the state of Minnesota, having its principal office in the city of Minneapolis in said state, and, during all of said time, has been and is an inhabitant of the District of Minnesota, and of the Fourth Division of said district.

2. The defendant, on the 27th day of February, 1913, and for a long period prior thereto, was, has been since, and now is, the Collector of Internal Revenue of the United States for the District of Minnesota, duly commissioned as such collector pursuant to the laws of the United States, and is an inhabitant of the District of Minnesota and of the Third Division thereof.

3. The plaintiff was organized as a corporation as aforesaid, under the laws of the state of Minnesota, by the execution, filing and publication of its Articles of Incorporation,

a copy of which, marked Exhibit "A," is hereto attached, and is hereby referred to and made a part of this complaint.

17 The plaintiff was so organized for the primary purposes of receiving, and uniting in one ownership, the title to certain lands, until then held by its numerous stockholders in individual ownership, in proportions varying from one-fourth (¼) to one one-hundred-and-eighth (1/108) thereof, and of liquidating and converting the same into money and distributing the proceeds thereof to said various owners in proportion to their former respective holdings in said lands. After its incorporation as aforesaid, the plaintiff received from its stockholders, and has ever since been the owner of, the said lands, subject to the rights of the vendees of the iron ore therein, as hereinafter alleged. The plaintiff corporation was not organized for profit, or with a view to carrying on or doing business; and, at no time since its organization as aforesaid, has the plaintiff carried on or done business of any kind, either for profit or otherwise; and the plaintiff is not, and never has been, a corporation subject to assessment for, or liable to pay to the United States, a special excise tax under the Act of Congress of August 5, 1909, or any other law.

4. At the time of the incorporation of the plaintiff, the only substantial value in its said lands consisted in deposits of iron ore thereon, and no substantial value therein has since developed or now exists. Prior to the incorporation of plaintiff, the iron ore upon portions of said land has been sold by the individual owners thereof, at and for a fixed and stated price per ton, and said lands were conveyed to and acquired by the plaintiff subject to the contracts of such sales, and no other sales of any ore thereon have been made. The income of the plaintiff during the years 1909, 1910 and 1911 was derived almost exclusively from payments made under said contracts of
18 sale of iron ore, and no part of said income was derived from the carrying on or doing of any business.

5. The value of said iron ore so sold as aforesaid was fixed by said contracts, and, irrespective of any fluctations in the market value thereof in the hands of the vendees of said ore or their succesors in interest therein, the value of said ores to the plaintiff is not, and can never be, other or greater than the sum named in its contracts of sale of said ore, and there has been, and can be, no increment in value or any profit as respects the plaintiff in said ores or lands.

6. On the 28th of December, 1909, the plaintiff duly amended its said Articles of Incorporation in the manner provided by the laws of the state of Minnesota, in order more clearly to

set forth the original purposes and intentions of the incorporators, so that Article I thereof was changed from the form in which it was originally adopted as set forth in Exhibit "A", and the purposes and powers of the plaintiff were limited, and became as follows, to-wit:

"The general purpose of the corporation is to unite in one ownership the undivided fractional interests of its various stockholders in lands, tenements and hereditaments, and to own such property, and, for the convenience of its stockholders, to receive, and distribute among them, the proceeds of any disposition of such property at such times, in such amounts, and in such manner, as the board of directors may determine."

The purposes and powers of the plaintiff have since been, and now are, restricted by said amendment a aforesaid and, the plaintiff, since the date last named, has not been authorized to carry on or do business within the meaning of said Act of Congress of August 5, 1909.

19 7. After the approval of said Act of August 5, 1909, the defendant, as such collector as aforesaid, transmitted to plaintiff printed forms prepared under the direction of the United States Commissioner of Internal Revenue for the making of a return by plaintiff of its income for the year 1909, as required by said Act. Plaintiff forthwith notified the defendant that it was not, and during the year 1909 had not been, carrying on or doing any business; that it had derived no income whatsoever from carrying on or doing business during said year; that it was not a corporation organized for profit, and was not subject to the provisions of said Act of August 5th, and was not liable to pay the excise tax therein provided for.

Thereafter, during a long period, correspondence and negotiations relative to the liability of plaintiff to make return of income under said Act of August 5th was conducted between the plaintiff and the defendant acting under the instructions of the United States Commissioner of Internal Revenue, which correspondence and negotiations were finally concluded in the month of September, 1912, by the decision of said Commissioner that the plaintiff was subject to the provisions of said Act of August 5, 1909, and liable to pay the excise tax provided for by said Act. Awaiting such decision, and solely by reason of the delay of said Commissioner in arriving at and announcing the same, plaintiff refrained from preparing and filing its returns of income required by said Act, until the dates hereinafter mentioned.

8. On or about the 26th day of September, 1912, in pursuance of said decision of said Commissioner, the defendant, as such collector as aforesaid, demanded of the plaintiff the making and filing by it, in the office of said collector, of a return, in the form prescribed by the Commissioner, of the net
20 income of the plaintiff for the years 1910 and 1911, and threatened the plaintiff with the imposition of the penaltie prescribed by said Act of Congress of August 5, 1909, in case of non-compliance with said demand. Pursuant thereto, but under protest, nevertheless, that it did not come within the purview of said Act of Congress, that it was not a corporation organized for profit, and that it was not carrying on or doing business during said years, and moved thereto solely by the treat of said penalties, and under the duress thereof, the plaintiff, on or about the 23rd day of October, 1912, filed with the defendant true and accurate returns of its income for said years of 1910 and 1911, respectively. During each of said years there had occurred an actual depreciation in value of the property and capital assets of the plaintiff, and each of said returns showed such depreciation of the property of the plaintiff during the year therein referred to, and other deductions, as authorized by the law, in an aggregate amount in excess of the gross income of the plaintiff for such year.

9. Thereafter, on or about December 20, 1912, the defendant, as such collector, in like manner as aforesaid, and with a similar threat of the imposition of the penalties of said Act of Congress in case of non-compliance by plaintiff with said demand, demanded from, and required of, plaintiff that it make and file with the defendant, as such collector, a return of its income for the year 1909. Pursuant thereto, the plaintiff made and filed with the defendant, in the manner required by law, on or about January 14, 1913, a return of its income for said year 1909, which showed a depreciation in the property and capital assets of the plaintiff, and other deductions authorized by law, in an amount in excess of the gross income of the plaintiff for said year. Said depreciation actually occurred and said other
21 deductions were actually paid out by plaintiff during said year. Said return was so made and filed under protest, however, that plaintiff was not a corporation organized for profit, that it was not carrying on or doing business during said year 1909, and that it was not a corporation falling within the purview of said Act of Congress.

10. Notwithstanding the exemption of plaintiff from liability to pay any excise tax under said Act of Congress, and notwithstanding the depreciation in the value of its property and the deductions allowed by law during each of said years,

the Commissioner of Internal Revenue of the United States assessed against the plaintiff a tax amounting to $187.92, as a corporation tax for the year 1909 under the internal revenue laws of the United States, and, in addition thereto, as a penalty for the alleged wrongful delay of the plaintiff in making and filing its return for said year, the sum of $93.96, making a total of $281.88; and said Commissioner assessed against the plaintiff, for the year 1910, under said laws, a tax of $175.34, and, in addition thereto, as a penalty for the alleged wrongful delay of the plaintiff in making and filing its return for said year, the sum of $87.67, making a total of $263.01; and for the year 1911, said Commissioner assessed a similar tax under said laws in the sum of $176.43, and, in addition thereto, as a penalty for the alleged wrongful delay of plaintiff in making and filing its return for said year, the sum of $88.22, making a total of $264.65.

On the 25th of January, 1913, the defendant, as such collector as aforesaid, notified the plaintiff of each of such assessments and demanded payment of said sums on or before the 6th day of February, 1913, and threatened, unless said sums were paid on or before said last named date, to
22 collect the same by distraint and sale of plaintiff's property, together with the penalties and interest in such case collectible under said law.

11. After the making of said demands by the defendant, the plaintiff duly made and filed with the defendant, in the form and manner provided by the law and in accordance with the practice in such case prescribed, a claim for abatement of said taxes so assessed by said Commissioner for each of said years, upon the grounds that the plaintiff was not subject to such tax and that the same was illegally assessed. Said claims were duly received and considered by said Commissioner, and, on the 15th day of February, 1913, were, and each of them was, rejected. Thereafter, on the 18th day of February, 1913, the defendant, as such collector as aforesaid, demanded from plaintiff the payment of said tax for each of said years on or before ten days, and threatened, in case of non-compliance therewith, to proceed to collect the same by distraint and sale of plaintiff's property, with penalties and interest as specified in the law.

12. For its first cause of action, the plaintiff further alleges that, pursuant to the demand therefor, and moved thereto by said threat of the defendant, and under the duress thereof, it paid to the defendant, on or about the 28th day of February, 1913, for and on account of said tax for the year 1909 and the

addition thereto, the sum of $281.88; that plaintiff had no net income during said year, and that said tax was illegally assessed and unauthorized by law, for the reasons hereinbefore stated, as defendant was informed and well knew prior to demanding and receiving the same; and the requirement of payment thereof by the defendant and the receipt thereof by him were illegal and wrongful; that thereafter, and prior to
23 the commencement of this action, the plaintiff duly made and filed with the defendant its claim for the refunding of said payment and a demand for the refundment thereof, which claim and demand were rejected and refused; there is now due and owing to the plaintiff, from and by the defendant, the sum of $281.88, with interest thereon at the rate of six per centum per annum from February 28, 1913.

13. For its second cause of action herein, the plaintiff hereby refers to and re-alleges each and every of the foregoing paragraphs numbered 1 to 11, both inclusive, and further alleges that, pursuant to the demand therefor, and moved thereto by said threat of the defendant, and under the duress thereof, it paid to the defendant, on or about the 28th day of February, 1913, for and on account of said tax for the year 1910 and the addition thereto, the sum of $263.01; that plaintiff had no net income during said year, and that said tax was illegally assessed and unauthorized by law, for the reasons hereinbefore stated, as defendant was informed and well knew prior to demanding and receiving the same, and the requirement of payment thereof by the defendant and the receipt thereof by him were illegal and wrongful; that thereafter, and prior to the commencement of this action, the plaintiff duly made and filed with the defendant its claim for the refunding of said payment and a demand for the refundment thereof, which claim and demand were rejected and refused; there is now due and owing to the plaintiff, from and by the defendant, the sum of $263.01, with interest thereon at the rate of six per centum per annum from February 28, 1913.

14. For its third cause of action herein, the plaintiff hereby refers to and re-alleges each and every of the foregoing paragraphs numbered 1 to 11, both inclusive, and further
24 alleges that, pursuant to the demand therefor and moved thereto by said threat of the defendant, and under the duress thereof, it paid to the defendant on or about the 28th day of February, 1913, for and on account of said tax for the year 1911 and the addition thereto, the sum of $264.65; that plaintiff had no net income during said year, and that said tax was illegally assessed and unauthorized by law, for the reasons hereinbefore stated, as defendant was informed and well knew

prior to demanding and receiving the same, and the requirement of payment thereof by the defendant and the receipt thereof were illegal and wrongful; that thereafter, and prior to the commencement of this action, the plaintiff duly made and filed with the defendant its claim for the refunding of said payment and a demand for the refundment thereof, which claim and demand were rejected and refused: there is now due and owing to the plaintiff from and by the defendant the sum of $264.65, with interest thereon at the rate of six per centum per annum from February 28, 1913.

15. This cause arises under the laws of the United States providing for internal revenue and this court has jurisdiction thereof.

Wherefore, plaintiff demands judgment against the defendant for the sum of eight hundred and nine dollars and fifty-four cents ($809.54), with interest thereon at the rate of six per centum per annum from February 28, 1913, together with its costs and disbursements herein.

FRED B. SNYDER,
EDWARD C. GALE,
Attorneys for Plaintiff,
810 Security Bank Building,
Minneapolis, Minnesota.

John R. Van Derlip, of Counsel.

25 Exhibit "A"

Articles of Incorporation of
Sutton Land Company.

We, the undersigned, for the purpose of forming a corporation under and pursuant to the provision of Title 2 of Chapter 34, General Statutes of Minnesota 1894, and the acts amendatory thereof, do hereby associate ourselves as a body corporate, and do hereby adopt the following Articles of Incorporation.

Article I.

The name of this corporation shall be the "Sutton Land Company."

The general nature of its business shall be the buying, owning, exploring and developing, leasing, improving, selling and dealing in, lands, tenements and hereditaments and the doing of all things necessary or incidental to the things above specified.

The principal place of transacting said business shall be at the city of Minneapolis in Hennepin County, Minnesota.

Article II.

The time for the commencement of this corporation shall be the twentieth day of February, A. D. 1906, and the period of continuance of this corporation shall be thirty (30) years.

Article III.

The amount of the capital stock of this corporation shall be One Hundred and Eight Thousand Dollars ($108,000), which shall be paid in, in money or property, in such manner and at such times as the Board of Directors may from time to time direct.

Article IV.

The highest amount of indebtedness or liability to which this corporation shall at any time be subject shall be the sum of One-Hundred Thousand Dollars ($100,000).

Article V.

The names and places of residence of the persons forming this association for incorporation, shall be John M. Longyear of Marquette County, Michigan, Russell M. Bennett of Deephaven, Minnesota, Alfred F. Pillsbury, Fred B. Snyder and Carleton C. Pillsbury, all of Minneapolis, Minnesota.

Article VI.

The names of the first Board of Directors of said corporation are John M. Longyear, Russell M. Bennett, Edmund J. Longyear, Norman C. Richardson, Helen H. Bennett, Alfred F. Pillsbury, Charles S. Pillsbury, Fred B. Snyder, Carleton C. Pillsbury and Frank H. Carleton. The first president shall be the said John M. Longyear. The first vice-president shall be the said Charles S. Pillsbury. The first secretary and treasurer shall be the said Russell M. Bennett.

The government of this corporation and the management of its affairs shall be vested in a board of ten directors and in a president, vice-president, secretary and treasurer, and such other officers and agents as may be from time to time ap-
26 pointed by the Board of Directors. Said directors and officers above named, shall hold their respective offices until the first Tuesday of December, 1906, at which time, and on every succeeding first Tuesday of December thereafter, a board of ten directors shall be elected by the stockholders of said corporation, at an annual meeting of said stockholders to be held at the office of the corporation in the city of Minneapolis, or such other place as the board of directors may direct. Immediately after the election of the directors, or as soon there-

after as practicable, the directors shall meet and elect from their number or from the stockholders of the corporation, a president, vice-president, secretary and treasurer. Any member of the board of directors or any stockholder of the corporation may fill any two of said offices except that of president and vice-president, which offices shall not be filled by the same person. The directors and officers of this corporation shall hold their respective offices until their successors have been duly elected and shall enter upon the duties. In case of a vacancy in the board of directors on account of death, resignation or removal, a special meeting of the stockholders shall be called within forty-five (45) days thereafter and a new director elected to fill such vacancy in the manner hereinafter provided. In case of a vacancy in the office of president, vice-president, secretary or treasurer, caused by death, resignation or removal, the directors of said corporation, when the board of directors is filled as hereinabove provided, shall fill such vacancy. Regular and special meetings of the directors and stockholders may be held at such times and under such rules as may be prescribed by the by-laws of such corporation, but the first meetings of the Board of Directors and the stockholders of said corporation shall be held at the office of the corporation in the city of Minneapolis, Minnesota, on the second Tuesday of May A. D. 1906, at ten and eleven o'clock in the forenoon, respectively. Any director may be represented at any meeting of the Board of Directors by proxy if the stockholders of this corporation shall authorize such representation by by-law.

Article VII.

The capital stock of this corporation shall be divided into two thousand one hundred and sixty (2,160) shares of Fifty Dollars ($50) each.

Article VIII.

No sale, assignment, transfer, hypothecation, pledge or other disposition of any stock in this corporation, shall be valid or effectual for any purpose, until there has first been endorsed upon the stock certificate to be affected by such sale, assignment, transfer, hypothecation, pledge or other disposition, the approval or consent of a majority of the Board of Directors of such corporation, sitting as a Board, to such sale, assignment, transfer, hypothecation, pledge or other disposition.

Article IX.

No mining lease or any interest therein owned by the corporation, shall ever be hypothecated, sold, assigned or transferred nor shall any real estate or any interest therein owned

by this corporation, ever be mortgaged, sold, conveyed or leased for a period longer than one year, except upon the affirmative vote of the holders of seventy-five per cent (75%) of the shares of the capital stock of the corporation actually issued and outstanding, given at a regular or special meeting of the stockholders.

27 Article X.

The title to the properties belonging to this corporation having been prior to the transfer thereof to the corporation, vested in various persons owning, respectively, different undivided interests therein, and such owners having been, at the time of such transfer to the corporation, divided into two general classes, to-wit: the heirs at law, assigns and devisees of George A. Pillsbury and Margaret S. Pillsbury, his wife, Charles A. Pillsbury and Mary A. Pillsbury, his wife, and John S. Pillsbury, all deceased constituting the class known as "The Pillsbury Heirs", who owned collectively an equal one-half part of all said properties, and Russell M. Bennett and John M. Longyear, constituting the other of said classes, who owned as tenants in common the other undivided one-half of all said properties; and this corporation having been formed, by mutual agreement of all said owners of both classes, for the more convenient handling, improvement, development and disposition of said properties, and it being the desire and intention of all said owners that an equal voice, in all matters relative to said properties, shall remain, and be maintained in the future, in said two classes:

It is hereby established as the perpetual and undeviating rule of this corporation that one-half of the entire board of directors of this corporation shall always be nominated by, and elected to represent, each of said two classes of former owners, so that, as long as the whole number of directors shall be ten, five directors, and five only, shall be chosen by the stockholders of this corporation from the nominees of "The Pillsbury Heirs" constituting one class, and five directors, and five only, shall be chosen by such stockholders from nominees of said Bennett and said Longyear constituting the other class.

In case a vacancy shall occur in said board of directors, such vacancy shall be filled by a nominee of the class by which the director whose retirement caused such vacancy was nominated; and until this article shall be altered or abrogated by the vote of the stockholders of this corporation, as hereinafter provided, the equal division, numerically, of said board of directors shall

be strictly maintained, so that said "Pillsbury Heirs" and their successors in interest shall always be represented upon the board of directors of this corporation by one-half of the full authorized number of directors, and said Bennett and Longyear, and their successors in interest, shall always be [repsesented] upon said Board by one-half of the full authorized number of directors, and no amendment of these Articles of Incorporation shall be made changing the number of Directors, except to an even number.

Article XI.

Article X of these Articles cannot be altered, amended or abrogated except by the vote of ninety (90) per cent of the shares of the capital stock of this corporation actually issued and outstanding, nor can any other Article be altered, amended or abrogated, except by the vote of seventy-five (75) per cent of the shares of the capital stock of this corporation, actually issued and outstanding, the vote in every case to be taken at a regular meeting of the stockholders, or at a special meeting of the stockholders called for that purpose.

Article XII.

Articles VIII and X and XI of these Articles of Incorporation shall be printed in full upon and as a part of every certificate of stock issued by this corporation.

Article XIII.

No by-law of this corporation embodying the provisions of Article X of these Articles of Incorporation shall be altered, amended or abrogated except by the vote of ninety (90)
28 per cent of the shares of the capital stock of this corporation actually issued and outstanding, nor can any other by-law be altered or amended except by the affirmative vote of seventy-five (75) per cent of the capital stock of this corporation, actually issued and outstanding, the vote in every case to be taken at a regular meeting of the stockholders, or at a special meeting of the stockholders called for that purpose.

In Witness Whereof, We have hereunto set our hands and seals this 26th day of January, A. D. 1906.

In Presence of:

J. E. Sherman,
Emily McNulty,
As to John M. Longyear.
Harvey E. Coleman,
Clara B. Martin,
As to all other signers.

(Seal) RUSSELL M. BENNETT.
(Seal) JOHN M. LONGYEAR.
(Seal) ALFRED F. PILLSBURY.
(Seal)* FRED B. SNYDER.
(Seal) CARLETON C. PILLSBURY.

State of Michigan,
County of Marquette—ss.

On this 26th day of January, A. D. 1906, before me, a notary public within and for said County, personally appeared John M. Longyear, to me known to be the person mentioned in and who executed the foregoing instrument, and acknowledged that he executed the same as his free act and deed.

JAMES E. SHERMAN,
Notary Public, Marquette County, Michigan.

State of Minnesota,
County of Hennepin—ss.

On this 9th day of February, A. D. 1906, before me, a notary public within and for said county, personally appeared Russell M. Bennett, Alfred F. Pillsbury, Fred B. Snyder and Carleton C. Pillsbury, to me known to be the persons mentioned in and who executed the foregoing instrument, and acknowledged that they executed the same as their free act and deed.

HARVEY E. COLEMAN,
Notary Public, Hennepin County, Minn.

My commission expires May 1st, 1912.

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29 State of Minnesota,
County of Hennepin—ss.

Russell M. Bennett, being first duly sworn upon his oath says that he is the Secretary and Treasurer of Sutton Land Company, plaintiff in the foregoing and within entitled action; that he has heard read the foregoing complaint and that the same is true of his own knowledge, except as to those matters therein stated on information and belief and as to such matters he believed it to be true.

RUSSELL M. BENNETT,

Subscribed and sworn to before me this 14th day of April, A. D. 1913.

(Notarial Seal) EDW. C. GALE,
Notary Public, Hennepin County, Minnesota.

My commission expires March 11th, 1914.

Endorsed: Filed in the District Court on April 15, 1913.

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30 (Complaint of Kearsarge Land Company.)

Kearsarge Land Company, a corporation, Plaintiff,
vs.
Fred Von Baumbach, Collector of Internal Revenue, Defendant.

The plaintiff, complaining of the defendant above named, alleges:

1. The plaintiff is, and since the 20th day of February, 1906, has been, a corporation having a capital stock duly organized and existing under the laws of the state of Minnesota, having its principal office in the city of Minneapolis in said state and during all of said time, has been and is an inhabitant of the District of Minnesota, and of the Fourth Division of said district.

2. The defendant, on the 27th day of February, 1913, and for a long period prior thereto, was, has been since, and now is, the Collector of Internal Revenue of the United States for the District of Minnesota, duly commissioned as such collector pursuant to the laws of the United States, and is an inhabitant of the District of Minnesota and of the Third Division thereof.

3. The plaintiff was organized as a corporation as aforesaid under the laws of the state of Minnesota, by the execution, filing and publication of its Articles of Incorporation, a copy of which, marked Exhibit "A", is hereto attached, and is hereby referred to and made a part of this complaint.

31 The plaintiff was so organized for the primary purposes of receiving, and uniting in one ownership, the title to certain lands, until then held by its numerous stockholders in individual ownership, in proportions varying from one-fourth (¼) to one one-hundred-and-eighth (1/108) thereof, and of liquidating and converting the same into money and distributing the proceeds thereof to said various owners in proportion to their former respective holdings in said lands. After its incorporation as aforesaid, the plaintiff received from its stockholders, and has ever since been the owner of, the said lands, subject to the rights of the vendees of the iron ore therein, as hereinafter alleged. The plaintiff corporation was not organized for profit, or with a view to carrying on or doing business; and, at no time since its organization as aforesaid, has the plaintiff carried on or done business of any kind, either for profit or otherwise; and the plaintiff is not, and never has been, a corporation subject to assessment for, or liable to pay to the United States, a special excise tax under the Act of Congress of August 5, 1909, or any other law.

4. At the time of the incorporation of the plaintiff, the only substantial value in its said lands consisted in deposits of iron ore thereon and no substantial value therein has since developed or now exists. Prior to the incorporation of plaintiff, the iron ore upon portions of said land had been sold by the individual owners thereof, at and for a fixed and stated price per ton, and said lands were conveyed to and acquired by the plaintiff subject to the contracts of such sales, and no other sales of any ore thereon have been made. The income of the plaintiff during the years 1909, 1910 and 1911 was derived almost exclusively from payments made under said contracts of
32 sale of iron ore, and no part of said income was derived from the carrying on or doing of any business.

5. The value of said iron ore so sold as aforesaid was fixed by said contracts, and, irrespective of any fluctuations in the market value thereof in the hands of the vendees of said ore or their successors in interest therein, the value of said ores to the plaintiff is not, and can never be, other or greater than the sum named in its contracts of sale of said ore, and there has been, and can be, no increment in value or any profit as respects the plaintiff in said ores or lands.

6. On the 28th of December, 1909, the plaintiff duly amended its said Articles of Incorporation in the manner provided by the laws of the state of Minnesota, in order more clearly to set forth the original purposes and intentions of the incorporators, so that Article I thereof was changed from the form in which it was originally adopted as set forth in Exhibit "A", and the purposes and powers of the plaintiff were limited, and became as follows, to-wit:

"The general purpose of the corporation is to unite in one ownership the undivided fractional interests of its various stockholders in lands, tenements and hereditaments, and to own such property, and, for the convenience of its stockholders, to receive, and distribute among them, the proceeds of any disposition of such property at such times, in such amounts, and in such manner, as the board of directors may determine."

The purposes and powers of the plaintiff have since been, and now are, restricted by said amendment as aforesaid, and the plaintiff, since the date last named, has not been authorized to carry on or do business within the meaning of said Act of Congress of August 5, 1909.

33 7. After the approval of said Act of August 5, 1909, the defendant, as such collector as aforesaid, transmitted to plaintiff printed forms prepared under the direction of the United States Commissioner of Internal Revenue for the mak-

ing of a return by plaintiff of its income for the year 1909, as required by said Act. Plaintiff forthwith notified the defendant that it was not, and during the year 1909 had not been, carrying on or doing any business; that it had derived no income whatsoever from carrying on or doing buiness during said year; that it was not a corporation organized for profit, and was not subject to the provisions of said Act of August 5th, and was not liable to pay the excise tax therein provided for.

Thereafter, during a long period, correspondence and negotiations relative to the liability of plaintiff to make return of income under said Act of August 5th was conducted between the plaintiff and the defendant acting under the instructions of the United States Commissioner of Internal Revenue, which correspondence and negotiations were finally concluded in the month of September, 1912, by the decision of said Commissioner that the plaintiff was subject to the provisions of said Act of August 5, 1909, and liable to pay the excise tax provided for by said Act. Awaiting such decision, and solely by reason of the delay of said Commissioner in arriving at and announcing the same, plaintiff refrained from preparing and filing its returns of income required by said Act until the dates hereinafter mentioned.

8. On or about the 26th day of September, 1912, in pursuance of said decision of said Commissioner, the defendant, as such collector as aforesaid, demanded of the plaintiff the making and filing by it, in the office of said collector, of a return, in the form prescribed by the Commissioner, of the net in-
34 come of the plaintiff for the years 1910 and 1911, and threatened the plaintiff with the imposition of the penalties prescribed by said Act of Congress of August 5, 1909, in case of non-compliance with said demand. Pursuant thereto, but under protest, nevertheless, that it did not come within the purview of said Act of Congress, that it was not a corporation organized for profit, and that it was not carrying on or doing business during said years, and moved thereto solely by the threat of said penalties, and under the duress thereof, the plaintiff, on or about the 23rd day of October, 1912, filed with the defendant true and accurate returns of its income for said years of 1910 and 1911, respectively. During each of said years there had occurred an actual depreciation in value of the property and capital assets of the plaintiff, and each of said returns showed such depreciation of the property of the plaintiff during the year therein referred to, and other deductions as authorized by the law, in an aggregate amount in excess of the gross income of the plaintiff for such year.

9. Thereafter, on or about December 20, 1912, the defendant, as such collector, in like manner as aforesaid, and with a similar threat of the imposition of the penalties of said Act of Congress in case of non-compliance by plaintiff with said demand, demanded from, and required of, plaintiff that it make and file with the defendant, as such collector, a return of its income for the year 1909. Pursuant thereto, the plaintiff made and filed with the defendant, in the manner required by law, on or about January 14, 1913, a return of its income for said year 1909, which showed a depreciation in the property and capital assets of the plaintiff, and other deductions authorized by law, in an amount in excess of the gross income of the plaintiff for said year. Said depreciation actually oc-
35 curred and said other deductions were actually paid out by plaintiff during said year. Said return was so made and filed under protest, however, that plaintiff was not a corporation organized for profit, that it was not carrying on or doing business during said year 1909 ,and that it was not a corporation falling within the purview of said Act of Congress.

10. Notwithstanding the exemption of plaintiff from liability to pay any excise tax under said Act of Congress, and notwithstanding the depreciation in the value of its property and the deductions allowed by law during each of said years, the Commissioner of Internal Revenue of the United States assessed against the plaintiff a tax amounting to $1053.11, as a corporation tax for the year 1909 under the internal revenue laws of the United States, and, in addition thereto, as a penalty for the alleged wrongful delay of the plaintiff in making and filing its return for said year, the sum of $526.56, making a total of $1579.67; and said commissioner assessed against the plaintiff, for the year 1910, under said laws, a tax of $1184.58, and, in addition thereto, as a penalty for the alleged wrongful delay of the plaintiff in making and filing its return for said year, the sum of $592.29, making a total of $1776.87; and for the year 1911, said commissioner assessed a similar tax under said laws in the sum of $1342.97, and, in addition thereto, as a penalty for the alleged wrongful delay of plaintiff in making and filing its return for said year, the sum of $671.49, making a total of $2014.46.

On the 25th of January, 1913, the defendant, as such collector as aforesaid, notified the plaintiff of each of such assessments and demanded payment of said sums on or before the 6th day of February, 1913, and threatened, unless
36 said sums were paid on or before said last named date, to collect the same by distraint and sale of plaintiff's

property, together with the penalties and interest in such case collectible under said law.

11. After the making of said demands by the defendant, the plaintiff duly made and filed with the defendant, in the form and manner provided by the law and in accordance with the practice in such case prescribed, a claim for abatement of said taxes so assessed by said commissioner for each of said years, upon the grounds that the plaintiff was not subject to such tax and that the same was illegally assessed. Said claims were duly received and considered by said commissioner, and, on the 15th day of February, 1913, were, and each of them was, rejected. Thereafter, on the 18th day of February, 1913, the defendant, as such collector as aforesaid, demanded from plaintiff the payment of said tax for each of said years on or before ten days, and threatened, in case of non-compliance therewith, to proceed to collect the same by distraint and sale of plaintiff's property, with penalties and interest as specified in the law.

12. For its first cause of action, the plaintiff further alleges that, pursuant to the demand therefor, and moved thereto by said threat of the defendant, and under the duress thereof, it paid to the defendant, on or about the 28th day of February, 1913, for and on account of said tax for the year 1909 and the addition thereto, the sum of $1579.67; that plaintiff had no net income during said year, and that said tax was illegally assessed and unauthorized by law, for the reasons hereinbefore stated, as defendant was informed and well knew prior to demanding and receiving the same; and the requirement of payment thereof by the defendant and the receipt thereof by him were illegal and wrongful; that thereafter, and
37 prior to the commencement of this action, the plaintiff duly made and filed with the defendant its claim for the refunding of said payment and a demand for the refundment thereof, which claim and demand were rejected and refused; there is now due and owing to the plaintiff, from and by the defendant, the sum of $1579.67, with interest thereon at the rate of six per centum per annum from February 28, 1913.

13. For its second cause of action herein, the plaintiff hereby refers to and re-alleges each and every of the foregoing paragraphs numbered 1 to 11, both inclusive, and further alleges that, pursuant to the demand therefor, and moved thereto by said threat of the defendant, and under the duress thereof, it paid to the defendant, on or about the 28th day

of February, 1913, for and on account of said tax for the year 1910 and the addition thereto, the sum of $1776.87; that plaintiff had no net income during said year, and that said tax was illegally assessed and unauthorized by law, for the reasons hereinbefore stated, as defendant was informed and well knew prior to demanding and receiving the same, and the requirement of payment thereof by the defendant and the receipt thereof by him were illegal and wrongful; that thereafter, and prior to the commencement of this action, the plaintiff duly made and filed with the defendant its claim for the refunding of said payment and a demand for the refundment thereof, which claim and demand were rejected and refused; there is now due and owing to the plaintiff, from and by the defendant, the sum of $1776.87, with interest thereon at the rate of six per centum per annum from February 28, 1913.

14. For its third cause of action herein, the plaintiff hereby refers to and re-alleges each and every of the foregoing paragraphs numbered 1 to 11, both inclusive, and further
38 alleges that, pursuant to the demand therefor and moved thereto by said threat of the defendant, and under the duress thereof, it paid to the defendant, on or about the 28th day of February, 1913, for and on account of said tax for the year 1911 and the addition thereto, the sum of $2014.46; that plaintiff had no net income during said year, and that said tax was illegally assessed and unauthorized by law, for the reasons hereinbefore stated, as defendant was informed and well knew prior to demanding and receiving the same, and the requirement of payment thereof by the defendant and the receipt thereof were illgal and wrongful; that thereafter, and prior to the commencement of this action, the plaintiff duly made and filed with the defendant its claim for the refunding of said payment and a demand for the refundment thereof, which claim and demand were rejected and refused; there is now due and owing to the plaintiff from and by the defendant the sum of $2014.46, with interest thereon at the rate of six per centum per annum from February 28, 1913.

15. This case arises under the laws of the United States providing for internal revenue and this court has jurisdiction thereof.

Wherefore, plaintiff demands judgment against the defendant for the sum of five thousand three hundred and seventy-one dollars ($5371.00), with interest thereon at the rate of

six per centum per annum from February 28, 1913, together with its costs and disbursements herein.

FRED B. SNYDER,
EDWARD C. GALE,
Attorneys for plaintiff.
810 Security Bank Building,
Minneapolis, Minn.

John R. Van Derlip,
of Counsel.

Exhibit "A."

39 Articles of Incorporation
of
Kearsarge Land Company

We, the undersigned, for the purpose of forming a corporation under and pursuant to the provisions of Title 2 of Chapter 34, general statutes of Minnesota, 1894, and the acts amendatory thereof, do hereby associate ourselves as a body corporate, and do hereby adopt the following articles of incorporation:

Article I.

The name of this corporation shall be the "Kearsarge Land Company."

The general nature of its business shall be the buying, owning, exploring and developing, leasing, improving, selling and dealing in lands, tenements and hereditaments, and the doing of all things necessary or incidental to the things above specified.

The principal place of transacting said business shall be at the city of Minneapolis, in Hennepin County, Minnesota.

Article II.

The time for the commencement of this corporation shall be the twentieth day of February, A. D. 1906, and the period of continuance of this corporation shall be thirty (30) years.

Article III.

The amount of the capital stock of this corporation shall be One Hundred and Eight Thousand Dollars ($108,000), which shall be paid in in money or property in such manner and at such times as the board of directors may from time to time direct.

Article IV.

The highest amount of indebtedness or liability to which this corporation shall at any time be subject shall be the sum of One Hundred Thousand Dollars ($100,000).

Article V.

The names and places of residence of the persons forming this association for incorporation shall be John M. Longyear of Marquette county, Michigan; Russell M. Bennett of Deephaven, Minnesota; Alfred F. Pillsbury, Edward C. Gale and Carleton C. Pillsbury, all of Minneapolis, Minnesota.

Article VI.

The names of the first board of directors of said corporation are John M. Longyear, Russell M. Bennett, Edmund J. Longyear, Norman C. Richardson, Helen H. Bennett, Alfred F. Pillsbury, Charles S. Pillsbury, Edward C. Gale, Carleton C. Pillsbury, and Frank H. Carleton. The first president shall be the said Alfred F. Pillsbury. The first vice president shall be the said Frank H. Carleton. The first secretary and treasurer shall be the said Russell M. Bennett.

The government of this corporation and the management of its affairs shall be vested in a board of ten directors and in a president, vice president, secretary and treasurer, and such other officers and agents as may be from time to time appointed by the board of directors. Said directors and officers above-named shall hold their respective offices until the first Tuesday of December, 1906, at which time, and on every succeeding first Tuesday of December thereafter, a board of ten directors shall be elected by the stockholders of said corporation at an annual meeting of said stockholders to be held at the office of the corporation in the city of Minneapolis, or such other place as the board of directors may direct. Immediately after the election of the directors, or as soon thereafter as practicable, the directors shall meet and elect from their number or from the stockholders of the corporation, a president, vice president, secretary and treasurer. Any member of the board of directors or any stockholder of the corporation may fill any two of said offices except that of president and vice president, which offices shall not be filled by the same person. The directors and officers of this corporation shall hold their respective offices until their successors have been duly elected and shall enter upon their duties. In case of a vacancy in the board of directors on account of death, resignation or removal, a special meeting of the stockholders shall be called within forty-five (45) days thereafter and a new director elected to fill such vacancy in the manner hereinafter provided. In case of a vacancy in the office of the president, vice president, secretary or treasurer, caused by death, resignation or removal, the directors of said corporation, when the board of directors is filled as hereinabove provided, shall fill such vacancy. Regular and special meetings of the directors and stockholders may

be held at such times and under such rules as may be prescribed by the by-laws of such corporation, but the first meetings of the board of directors and the stockholders of said corporation shall be held at the office of the corporation in the city of Minneapolis, Minnesota, on the second Tuesday of May, A. D. 1906, at ten and eleven o'clock in the forenoon, respectively. Any director may be represented at any meeting of the board of directors by proxy if the stockholders of this corporation shall authorize such representation by by-law.

Article VII.

The capital stock of this corporation shall be divided into two thousand one hundred and sixty (2,160) shares of Fifty Dollars ($50) each.

Article VIII.

No sale, assignment, transfer, hypothecation, pledge or other disposition of any stock in this corporation, shall be valid or effectual for any purpose, until there has first been endorsed upon the stock certificate to be affected by such sale, assignment, transfer, hypothecation, pledge or other disposition, the approval or consent of a majority of the Board of Directors of such corporation, sitting as a board, to such sale, assignment, transfer, hypothecation, pledge or other disposition.

Article IX.

No mining lease or any interest therein owned by the corporation, shall ever be hypothecated, sold, assigned or transferred, nor shall any real estate or any interest therein owned by the corporation, ever be mortgaged, sold, conveyed or leased for a period longer than one year except upon the affirmative vote of the holders of seventy-five per cent (75 per cent) of the shares of the capital stock of the corporation actu-
41 ally issued and outstanding, given at a regular or special meeting of the stockholders.

Article X.

The title to the properties belonging to this corporation having been, prior to the transfer thereof to the corporation, vested in various persons owning, respectively, different undivided interests therein, and such owners having been, at the time of such transfer to the corporation, divided into two general classes, to-wit: the heirs at law, assigns, and devisees of George A. Pillsbuty and Margaret S. Pillsbury, his wife, Charles A. Pillsbury and Mary A. Pillsbury, his wife, and John S. Pillsbury, all deceased, constituting the class known as "The Pills-

bury Heirs," who owned collectively an equal one-half part of all said properties, and Russell M. Bennett and John M. Longyear, constituting the other of said classes, who owned as tenants in common the other undivided one-half of all said properties; and this corporation having been formed, by mutual agreement of all said owners of both classes, for the more convenient handling, improvement, development, and disposition of said properties, and it being the desire and intention of all said owners that an equal voice, in all matters relative to said properties, shall remain, and be maintained in the future, in said two classes:

It is hereby established as the perpetual and undeviating rule of this corporation that one-half of the entire board of directors of this corporation shall always be nominated by, and elected to represent, each of said two classes of former owners, so that as long as the whole number of directors shall be ten, five directors, and five only, shall be chosen by the stockholders of this corporation from the nominees of "The Pillsbury Heirs" constituting one class, and five directors and five only, shall be chosen by such stockholders from nominees of said Bennett and said Longyear constituting the other class.

In case a vacancy shall occur in said board of directors, such vacancy shall be [fil-ed] by a nominee of the class by which the director whose retirement caused such vacancy was nominated; and until this article shall be altered or abrogated by the vote of the stockholders of this corporation, as hereinafter provided, the equal division, numerically, of said board of directors shall be strictly maintained, so that said "Pillsbury Heirs" and their successors in interest shall always be represented upon the board of directors of this corporation by one-half of the full authorized number of directors, and said Bennett and Longyear, and their successors in interest, shall always be represented upon said Board by one-half of the full authorized number of directors and no amendment of these Articles of Incorporation shall be made changing the number of Directors, except to an even number.

Article XI.

Article X of these Articles cannot be altered, amended or abrogated except by the vote of ninety (90) per cent of the shares of the capital stock of this corporation actually issued and outstanding, nor can any other Article be altered, amended or abrogated except by the vote of seventy-five (75) per cent of the shares of the capital stock of this corporation, actually issued and outstanding, the vote in every case to be taken at a regular meeting of the stockholders, or at a special meeting of the stockholders called for that purpose.

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Article XII.

Article VIII and X and XI of these Articles of Incorporation shall be printed in full upon and as a part of every certificate of stock issued by this corporation.

Article XIII.

No by-law of this corporation embodying the provisions of Article X of these Articles of Incorporation shall be altered, amended or abrogated except by the vote of ninety (90) per cent of the shares of the capital stock of this corporation actually issued and outstanding, nor can any other by-law be altered or amended except by the affirmative vote of seventy-five (75) per cent of the capital stock of this corporation, actually issued and outstanding, the vote in every case to be taken at a regular meeting of the stockholders, or at a special meeting of the stockholders called for that purpose.

In witness whereof, we have hereunto set our hands and seals this 26th day of January, A. D. 1906.

In Presence of:
J. E. Sherman,
Emily McNulty,
As to John M. Longyear.

Harvey E. Coleman,
Clara B. Martin,
As to all other signers.

(Seal) RUSSELL M. BENNETT,
(Seal) JOHN M. LONGYEAR,
(Seal) ALFRED F. PILLSBURY,
(Seal) EDWARD C. GALE,
(Seal) CARLETON C. PILLSBURY,

State of Michigan,
County of Marquette—ss.

On this 26th day of January, A. D. 1906, before me, a notary public within and for said county, personally appeared John M. Longyear, to me known to be the person mentioned in and who executed the foregoing instrument and acknowledged that he executed the same as his free act and deed.

(Notarial Seal) JAMES E. SHERMAN,
Notary Public, Marquette County, Mich.

State of Minnesota,
County of Hennepin—ss.

On this 9th day of February, A. D. 1906, before me, a notary public within and for said county, personally appeared Russell M. Bennett, Alfred E. Pillsbury, Edward C. Gale and Carleton C. Pillsbury, to me known to be the persons mentioned in and who executed the foregoing instrument, and acknowledged that they executed the same as their free act and deed.

(Notarial Seal) HARVEY E. COLEMAN,
Notary Public, Hennepin County, Minn.

My commission expires May 1st, 1912.

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43 State of Minnesota,
County of Hennepin—ss.

Russell M. Bennett being first duly sworn upon his oath says that he is the Secretary and Treasurer of Kearsarge Land Company, plaintiff in the foregoing and within entitled action; that he has heard read the foregoing complaint and that the same is true of his own knowledge, except as to those matters therein stated on information and belief and as to such matters he believes it to be true.

RUSSELL M. BENNETT.

Subscribed and sworn to before me this 14th day of April, A. D. 1913.

(Notarial Seal) EDW. C. GALE,
Notary Public, Hennepin County, Minnesota.

My Commission expires March 11th, 1914.

Endorsed: Filed in the District Court on April 15, 1913.

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44 (Amended Answer to Complaint of Sargent Land Co.)

Sargent Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

The defendant, for his answer to the complaint in the action above entitled, admits the allegations contained in Paragraphs one, two and the first four lines of Paragraph three, ending with the word "complaint".

Further answering, the defendant admits that the Commissioner of Internal Revenue, pursuant to the Act of Congress of August 5, 1909, assessed against the plaintiff taxes and penalties in the amounts and for the years as in plaintiff's complaint

alleged, and that the defendant, pursuant to said tax assessment and in manner and form as by law required, as such collector of internal revenue for the State and District of Minnesota, did demand and receive of the plaintiff the several sums in said complaint stated as and for the taxes theretofore assessed by the Commissioner of Internal Revenue under the Act aforesaid.

Further answering said complaint, defendant denies each and every allegation, matter and thing therein contained, save and except as the allegations of said complaint are herein admitted.

CHARLES C. HOUPT,
United States Attorney and
attorney for defendant.

State of Minnesota,
County of Ramsey—ss.

Charles C. Houpt, being first duly sworn, deposes and says that he is United States Attorney in and for the District of Minnesota, and Attorney for defendant in the above entitled action; that he has read the foregoing answer and knows the contents thereof and that the same is true of his own knowledge, except as to those matters therein stated on information and belief and as to such matters he believes it to be true; that he makes this affidavit for the reason that plaintiff in said action is absent from the county wherein affiant resides.

CHARLES C. HOUPT,

Subscribed and sworn to before me this 22nd day of September, A. D. 1913.

(Seal)

NORBERT B. TYRRELL,
Notary Public, Ramsey County, Minn.

My Commission expires Oct. 5, 1917.

Endorsed: Filed in the District Court on Sept. 23, 1913.

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45 (Amended Answer to Complaint of Sutton Land Co.)

Sutton Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

The defendant, for his answer to the complaint in the action above entitled, admits the allegations contained in Paragraphs one, two and the first four lines of Paragraph three, ending with the word "complaint".

Further answering, the defendant admits that the Commissioner of Internal Revenue, pursuant to the Act of Congress of August 5, 1909, assessed against the plaintiff taxes and penalties in the amounts and for the years as in plaintiff's complaint alleged, and that the defendant, pursuant to said tax assessment and in manner and form as by law required, as such collector of internal revenue for the State and District of Minnesota, did demand and receive of the plaintiff the several sums in said complaint stated as and for the taxes theretofore assessed by the Commissioner of Internal Revenue under the Act aforesaid.

Further answering said complaint, defendant denies each and every allegation, matter and thing therein contained, save and except as the allegations of said complaint are herein admitted.

CHARLES C. HOUPT,
United States Attorney and
attorney for defendant

State of Minnesota,
County of Ramsey—ss.

Charles C. Houpt, being first duly sworn, deposes and says that he is United States Attorney in and for the District of Minnesota, and Attorney for defendant in the above entitled action; that he has read the foregoing answer and knows the contents thereof and that the same is true of his own knowledge, except as to those matters therein stated on information and belief and as to such matters he believes it to be true; that he makes this affidavit for the reason that plaintiff in said action is absent from the county wherein affiant resides.

CHARLES C. HOUPT,

Subscribed and sworn to before me this 22nd day of September, A. D. 1913.

(Seal) NORBERT B. TYRRELL,
Notary Public, Ramsey County, Minn.

My Commission expires Oct. 5, 1917.

Endorsed: Filed in the District Court on Sept. 23, 1913.

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46 (Amended Answer to Complaint of Kearsarge Land Co.)

Kearsarge Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

The defendant, for his answer to the complaint in the action above entitled, admits the allegations contained in Paragraphs

one, two and the first four lines of Paragraph three, ending with the word "complaint."

Further answering, the defendant admits that the Commissioner of Internal Revenue, pursuant to theAct of Congress of August 5, 1909, assessed against the plaintiff taxes and penalties in the amounts and for the years as in plaintiff's complaint alleged, and that the defendant, pursuant to said tax assessment and in manner and form as by law required, as such collector of internal revenue for the State and District of Minnesota, did demand and receive of the plaintiff the several sums in said complaint stated as and for the taxes theretofore assessed by the Commissioner of Internal Revenue under the Act aforesaid,

Further answering said complaint, defendant denies each and every allegation, matter and thing therein contained, save and except as the allegations of said complaint are herein admitted.

CHARLES C. HOUPT,
United States Attorney and attorney for defendant.

State of Minnesota,
County of Ramsey—ss.

Charles C. Houpt, being first duly sworn, deposes and says that he is United States Attorney in and for the District of Minnesota, and Attorney for defendant in the above entitled action; that he has read the foregoing answer and knows the contents thereof and that the same is true of his own knowledge, except as to those matters therein stated on information and belief and as to such matters he believes it to be true; that he makes this affidavit for the reason that plaintiff in said action is absent from the county wherein affiant resides.

CHARLES C. HOUPT.

Subscribed and sworn to before me this 22nd day of September, A. D. 1913.

(Seal) NORBERT B. TYRRELL,
Notary Public, Ramsey County, Minn.

My Commission expires Oct. 5, 1917.

Endorsed: Filed in the District Court on Sept. 23, 1913.

48 (Judgment in favor of Sargent Land Co.)

Sargent Land Company, a Corporation, Plaintiff,

vs.

Fred von Baumbach, Collector of Internal Revenue, Defendant.

This case came on to be heard before the Court, a trial by jury therein having been duly waived in writing by the parties thereto, on the 29th, 30th and 31st days of July, 1913.

Mr. Van Derlip and Mr. Snyder appeared for the plaintiff.

Mr. Houpt, U. S. District Attorney, appeared for the defendant.

After hearing the evidence offered by the respective parties and the arguments of counsel thereon, I now make a general finding in favor of the plaintiff, and it is therefore now Ordered that the plaintiff recover of the defendant the sum of Seventeen thousand, one hundred and forty, 71/100ths dollars, ($17,140.71), with interest thereon at the rate of six percent per annum from February 28th, 1913, and its costs.

Dated August 5th, 1913.

CHARLES A. WILLARD,
Judge.

Endorsed: Filed in the District Court on Aug. 5, 1913.

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49 (Judgment in favor of Sutton Land Co.)

Sutton Land Company, a Corporation, Plaintiff,

vs.

Fred von Baumbach, Collector of Internal Revenue, Defendant.

This case came on to be heard before the Court, a trial by jury therein having been duly waived in writing by the parties thereto, on the 29th, 30th and 31st days of July, 1913.

Mr. Van Derlip and Mr. Snyder appeared for the plaintiff.

Mr. Houpt, U. S. District Attorney, appeared for the defendant.

After hearing the evidence offered by the respective parties and the arguments of counsel thereon, I now make a general finding in favor of the plaintiff, and it is therefore now Ordered that the plaintiff recover of the defendant the sum of Eight hundred and nine, 54/100ths Dollars ($809.54), with interest thereon at the rate of six per cent per annum from February 28th, 1913, and its costs.

Dated August 5th, 1913.

CHARLES A. WILLARD,
Judge.

Endorsed: Filed in the District Court on Aug. 5, 1913.

50 (Judgment in favor of Kearsarge Land Co.)

Kearsarge Land Company, a Corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

This case came on to be heard before the Court, a trial by jury therein having been duly waived in writing by the parties thereto, on the 29th, 30th and 31st days of July, 1913.

Mr. Van Derlip and Mr. Snyder appeared for the plaintiff.

Mr. Houpt, U. S. District Attorney, appeared for the defendant.

After hearing the evidence offered by the respective parties and the arguments of counsel thereon, I now make a general finding in favor of the plaintiff, and it is therefore now Ordered that the plaintiff recover of the defendant the sum of Five thousand three hundred and seventy-one Dollars ($5,371.00), with interest thereon at the rate of six per cent per annum from February 28th, 1913, and its costs.

Dated August 5th, 1913.

CHARLES A. WILLARD,
Judge.

Endorsed: Filed in the District Court on Aug. 5, 1913.

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51 (Stipulation that but one Bill of Exceptions be made and as to use of Record on Writs of Error.)

Sargent Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

Kearsarge Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

Sutton Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

It is hereby stipulated and agreed by and between the parties to the actions above entitled that said actions having been tried together to the court without a jury and a single record made of the evidence introduced by the parties at the trial thereof, that a single bill of exceptions may be made, filed and printed for all the purposes of said cases on writs of error from the Circuit Court of Appeals, Eighth Circuit, and that said record may stand for and be used in the Circuit Court of Appeals,

Eighth Circuit, as and for the record in each of said cases, to the same extent and in like manner as if a separate record had been prepared and printed in each of said cases.

SNYDER & GALE and
JOHN R. VAN DERLIP,
Attorneys for Plaintiffs.

CHARLES C. HOUPT,
United States Attorney and
Attorney for Defendant.

Endorsed: Filed in the District Court on Oct. 6, 1913.

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53 (Bill of Exceptions, filed in the District Court on October 6, 1913.)

These actions came on for trial before Hon. Charles A. Willard, U. S. District Judge without a jury, on the 29th day of July, 1913, in the Federal Building, Minneapolis, Minnesota.

Mr. C. C. Houpt U. S. District Attorney, for defendant.

Messrs. Snyder & Gale and Van Derlip & Lum for the plaintiffs.

54 Counsel for plaintiffs offers and reads in evidence a certain stipulation entered into between the respective parties, which is as follows:

Stipulation combining Actions for Trial.

It Is Hereby Stipulated, that the above entitled actions involving the same state of facts and the same issues, may be tried together and that all the testimony submitted by either party relative to said action shall be considered as submitted in each thereof; provided, however, that if either party shall desire to raise and have determined any issue of fact or of law in any one action which is not also involved in the others, such testimony may be submitted and such issue or issues presented for determination without prejudice by reason of this stipulation.

SNYDER & GALE,
JOHN VAN DERLIP,
Attorneys for Plaintiff.

CHARLES C. HOUPT,
Attorney for Defendant.

Dated, July 29, 1913.

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55 Order that Actions be Tried Together.

Upon reading the foregoing stipulation it is hereby ordered that the actions above entitled be tried together, and that the testimony offered and received on said trial shall be deemed to be offered and received in each of said actions; provided, however, that if any testimony be offered by either party material and relevant to any one or two of said actions, but not to all of them, and if any issue of fact or of law be presented in any one or two of said actions which is not involved in all thereof, such testimony may be received by the Court, and such issues may be considered and determined by the Court, notwithstanding the making of said stipulation and of this order.

CHARLES A. WILLARD,
Judge of the United States District Court for Minnesota.

Dated July 29, 1913.

(Testimony for Plaintiffs.)

The case on the part of the plaintiffs is then opened to the Court by Mr. Van Derlip.

Counsel for plaintiffs then reads to the Court the Articles of Incorporation of one of the plaintiff corporations, stating to the Court that the Articles of Incorporation of each of the plaintiff companies is similar to the one read at this time.

56 FREDERICK B. SNYDER, a witness produced and sworn on the part of the plaintiff, testifies as follows:

Examination in Chief

By Mr. Van Derlip:

Q. You live in Minneapolis? A. I do.

Q. You have lived here a great many years?

A. Fifty years, yes.

Q. Were you acquainted with the members of the firm of John S. Pillsbury & Co.? A. Yes.

Q. John S. Pillsbury, George A. Pillsbury and Charles A. Pillsbury in their life times?

A. I was intimately acquainted with them during their life times, and was for the last forty years.

Q. Were you prior to the time of his death connected by marriage with John S. Pillsbury?

A. I was his son in law.

Q. Were you during the years prior to 1888 more or less familiar with the affairs and property of the firm of John S Pillsbury & Co.?

A. Yes, I was quite familiar with them. A great many matters relating to lands were referred to me by the Pillsburys, I examined a great many titles; I think all of the titles covered by these three corporations, and matters relating to them were constantly referred to me.

Q. Will you be good enough to state, without my asking specific questions, the history of these titles now owned
57 by the Sergeant Land Company, the Kearsage Land Company and the Sutton Land Company, so as to get into the record the chain of title from John S. Pillsbury, George A. Pillsbury and Charles A. Pillsbury.

Mr. Houpt: Of course it would not be competent for this witness to state orally the condition of these titles, that being a matter of record.

The court overrules the objection, and counsel for defendant excepts to the ruling.

A. In the early seventies, the three Pillsburys, the elder George A. Pillsbury, the one we call Governor Pillsbury, being John S. Pillsbury, and Charles A. Pillsbury the son of George A. Pillsbury, were engaged in the land business for the purpose really of carrying on the lumber business. They were engaged in the lumber business, purchasing the lands that became incidental to that business under the name of John S. Pillsbury & Company, each owning a one-third interest in the copartnership. They bought many thousand acres of land in the northern part of the state, land that was valuable then for its timber. As years went by, these lands being especially valuable for their timber, they sold the timber, and in some cases they logged the lands, in other they sold them for manufacturing purposes. But in 1880 the State Geological survey disclosed the Range called the Messaba Range, supposed to contain iron,
which went through the holdings of John S. Pillsbury &
58 Company. In the latter part of 1889 or along in 1890 explorations were conducted along this range, and some ore was disclosed. Among those who were exploring was Mr. J. M. Longyear of Marquette, Michigan, who was engaged in the land business with Mr. Russell M. Bennett who is present here in court. They conceived the idea of exploring this district more extensively, and approached the Pillsburys for an option upon such lands as they might wish to select out of the Pillsbury's holdings, exclusive of the timber, in the northern part of the state, for the purpose of searching for iron. A tentative

agreement was entered into, and a limited time was given for Mr. Bennett and Mr. Longyear to look over the country. They went on and in a few months took an option on it, or took an option upon such lands as they might wish to select out of the Pillsbury's holdings, provided they found iron. They conducted their explorations, and in about 1892, as I recollect it, they made a demand for a deed, selecting the lands now covered by these three corporations, and demanded an undivided interest, as compensation for their exploration expenses for finding iron upon certain lands. A deed was made, so that the holdings in the land or the title to the land was then passed, one quarter to Mr. Bennett, one quarter to Mr. Longyear, and one-sixth to John S. Pillsbury, George A. Pillsbury and Charles A. Pillsbury, one-sixth to each.

59 Q. One-sixth to each? A. Yes, sir.

Q. Making a full title?

A. Yes. That was in 1892. It is, I think common knowledge that the exploration continued upon the range, and that the value of the range as a range became more apparent. Then in 1898 George A. Pillsbury died. He left a will, and generally, by its terms, the widow Margaret S. Pillsbury, took one-third which would be one-eighteenth and his son took an eighteenth.

Mr. Van Derlip: I suppose Mr. Houpt may make objections to this testimony, though I do not suppose there is any question about these matters.

Mr. Houpt: I will waive objection.

Witness: Mr. C. A. Pillsbury under the will took an undivided one-third, which would be one-eighteenth, and the children of the deceased son of George A. Pillsbury, Mr. Fred C. Pillsbury took the other eighteenth under the provision of the will leaving it to certain trustees until they became 25 years of age. So that we then have the title out of George A. Pillsbury, the Governor, still having one-sixth, C. A. Pillsbury having four-eighteenths, and the children of Fred. C. Pillsbury having in trust one-eighteenth, and Margaret S. Pillsbury one-eighteenth. That was in 1898, in 1899 C. A. Pillsbury died, leaving his four-eighteenths to his two sons in equal shares, each two-eighteenths. Then in March, 1901 the widow Margaret S. Pillsbury died. She, having one-eighteenth, left it so far as it

60 then remained in her, and I will explain what I mean by that statement, as far as it remained in her. There were four grandchildren by her son Fred. C. Pillsbury and two grandchildren by her son C. A. Pillsbury, and each had an undivided one-one hundred and eighth, making six-one hundred

and eighths, or one-eighteenth. But before her death she had conveyed her one-eighteenth or 6/108ths in the three properties known as the Monroe mine, the Glen mine and the Parce mine in equal proportions, 3/108ths each, to her daughters Mrs. Townsend and her relative Mr. Frank H. Carleton. That is the difference as far as the Kearsage Land Company is concerned, and that is the only difference. Governor Pillsbury died October 8th, 1901. He left a widow and a son Alfred S. Pillsbury, a daughter Sarah P. Gale, and a grand son John Pillsbury Snyder. He died without a will, so that the widow took one-third of one-sixth, being one-eighteenth, and the children and the grandchild each took one-third of the balance, or four-one hundred and eighths each. I think I omitted to say anything about the one-eighteenth which went to the four children of Fred. C. Pillsbury in trust, Mrs. Ayer, Carleton C. Pillsbury, Alice Pillsbury and Helen Pillsbury. That reduced the division to three-two hundred and sixteenths each, making twelve two hundred and sixteenths, or one-eighteenth. So this title was really divided down to points of two hundred
61 and [sixtten,] as a matter of fact.

You can readily see the complications which faced the parties interested in that title, which they all believed in the future had a large value. Leases were made in 1901 and 1902, if I remember right: the records will show. But several leases were made and they required the obtaining of these signatures; and in addition to that, there is a provision of the law which forbids a guardian from making a lease for more than 25 years, which impairs the value of mining leases, they being usually for 50 years or longer. I wish to have it put upon the record that when I signed one or two of these leases as guardian I had to give a guaranty, in order to have the leases made, that when my son became of age he would confirm the leases for a longer period than 25 years.

Q. You were guardian for your son?

A. I was, and for that reason I could not make a longer lease. There were other minors who were acting through guardians and trustees, and there were younger children who were getting married and were having children of their own. We were stared in the face with possible death of any of the minors for many many years to come. That was a possibility which stared us in the face. Another thing was that some small interest in these properties might get outside of what we considered the family; or some undesirable interest might
62 come in and complicate the title, and might harass and trouble us. So we were confronted with the problem of

in someway merging these properties into a single ownership, with the grave objections before us of having a trustee corporation, or to have the guardians incorporate. We did not want to do it, and yet we felt that we must take the chance. Then about this time there was an opportunity to purchase a forty acres from Mrs. Day, which we thought advisable to protect certain property which we had against an undesirable use of it; so we had negotiations for that Day forty. Then we had negotiations for a lease of a large quantity of this land with Mr. Hill. He wanted a long lease, an indeterminate lease, and he must have it. Their attorney was willing to take a lease from a corporation, with a guaranty that there would be a confirmation of the acts of any one acting as a guardian, at the proper time, as they could not take a valid lease for more than twenty five years from a guardian. So we were compelled by reason of all these things to do something. We decided to incorporate ten thousand acres in round figures, [enought] for three corporations, provided we put the three pieces in which the title differed into a separate corporation, and put the other in two others, making two corporations out of them, so as to cover the rest of the land, and thus bring it within the law. The only reasons we had for making three corporations, out of this property, and not one corporation, was, first,
63 that in three pieces of land the title differed; and the second reason was to comply with the law against corporations holding more than five thousand acres of land. The records will disclose, and there will be presented here evidence to show that each individual entering the corporation received from the corporation a certificate of stock representing exactly his undivided interest in the land taken over by the corporation. They will show and disclose also almost a jealous care taken by both sides of the friendliest nature by Longyear & Bennett on the one hand and the Pillsburys on the other hand, to forever maintain and keep inviolate the rights of all the parties to the one-half of this property, as far as it might be done through the corporation. It discloses the fact that the stockholders on either side can not operate unless a majority of each is present at the meeting; it shows that the directors can not act unless a majority representing each side be [present.] No leases or transfers of property can be made, except by a vote of 75 per cent of the stock.

Mr. Houpt: Are these all set out in the by-laws?

The Court: Perhaps it would be better to introduce them.

Mr. Van Derlip: They will be introduced.

Witness: The stock itself can not be transferred, except at a meeting of the board, by a majority endorsed on the back of the stock at an open meeting.

64 Mr. Houpt: That is objected to.

Mr. Van Derlip: I think this has a bearing upon the question as to what we had in mind when we organized.

The Court: The objection will be sustained.

Witness: The estates conveyed by the individuals to this corporation were only the properties which came through the Pillsburys and the Day forty, and the rights of the leases, all of which we were bound to carry out at the time we incorporated. I think I have substantially covered the history of things and the reasons for the incorporation.

Q. In these negotiations to which you have referred leading up to the organization of this corporation, did you have a part?

A. I did, from the inception.

Q. What interest did you represent?

A. I represented the Pillsbury interest, and also in a general way, I might say, both sides. I think we represented Longyear and Bennett, so we represented both sides.

Q. So that you were familiar with all these facts to which you have referred, and you knew of all the negotiations leading up to the organization of the corporation, and the transfer of this property to that corporation?

A. All I have told is from my personal knowledge.

Q. You were a director in this corporation.

A. I was during the minority of my son. I held one share for that purpose.

65 Q. You represented or held one share?

A. I held one [shore] for that purpose only. I represented my son's interest and the Pillsbury interest.

Q. You were one of the directors, representing the Pillsbury heirs? A. The Pillsbury heirs, yes.

Q. Since that time have you been familiar with the—I mean since your son succeeded you as a director, have you been familiar with all these matters?

A. I have been familiar as an attorney, and also.

Q. Who are the attorneys of record? A. Snyder & Gale.

Q. The Snyder being yourself? A. Yes, sir.

Q. I will ask you, Mr. Snyder the purpose of the organization of this corporation, particularly with respect to the end at which you aimed.

A. The whole purpose of the incorporation was to bring to the heirs [thrier] shares of the estate as fast as possible. This corporation was organized as a vehicle to accomplish that re-

sult, and for no other [pruposes]; to convert the assets into money and to distribute it to the stockholders as we have been doing.

Q. As a matter of fact, since the organization of the corporation what has been done with the money received by it?

A. It has been whenever received distributed to the stockholders in proper proportion, deducting only the necessary expenses of actually carrying on the office force.

[QL.] What has been done by this corporation during the period of [thier] existence, in the way of maintaining
66 separate offices?

A. Their offices have been in connection with the office of Mr. R. M. Bennett in this city. He is engaged in the land and mining business. To save expense, and to be as economical as possible, and to get as large a return as possible to the stockholders, it was arranged that they should be carried on in Mr. Bennett's office, and that a portion of the money paid to his office force should be charged up to these different companies.

Q. They have maintained no other office, except this in connection with Mr. Bennett's office?

A. They have had no other office.

Q. During the period of the existence of these corporations who has been the secretary and treasurer of them?

A. Mr. Russell M. Bennett has been and is secretary and treasurer of these three corporations.

Q. Since the organization of these corporations in 1906, what if any business have they or either of them carried on or been doing?

A. They have carried on and they are carrying on or doing no business other than the disposition of their properties and the distribution of the proceeds to the stockholders.

Q. Has any proportion of the proceeds received from time to time from the disposition of the property been used for any purpose by the corporations, except for distribution to the stockholders? A. None.

Q. I mean of course, except the necessary and inci-
67 dental expenses of the office to which you refer? A. No.

Q. Have all of those proceeds during the time involved in this suit from 1909 to 1911 been distributed as fast as received by the corporations?

A. As fast as received, with the exception of some moneys which have been retained a short [tiem] in connection with the Keewatin property.

Q. State what the Keewatin property is to which you refer.

A. The Keewatin property is a portion of the property of the Sargent Land Company covered by the Van Buren leases.

Q. The Van Buren lease upon its face provided for the payment of certain minimum amounts per year.

Q. I am speaking of the years 1909, 1910 and 1911. Has the company engaged in any transaction by way of investment or otherwise, except such as you have stated in your testimony?

A. None whatever.

Q. In any venture of any sort, with a view of gaining a profit for the [sto-kholders]? A. None whatever.

Q. In my opening statement to the court I referred to leases to the Van Buren Mining Company which you have mentioned, bearing date January 2, 1907; were you familiar with the negotiations leading up to the making of that lease?

A. I was from the inception.

Q. Will you please state when these negotiations, as near as you can recollect, were entered upon, and when they were concluded.

Mr. Houpt: That is objected to as immaterial, as to
68 any negotiations preceding the execution of the lease, because whatever was done prior to that time is merged in the lease.

The Court overrules the objection, and counsel for defendant excepts to the ruling.

A. To the best of my recollection, the first intimation of the negotiation was in December, 1905, just before the first of the year; or it might have been after that a little, it may have been immediately after the first of January, 1906. It was close to the beginning of the year 1906.

Q. When were those negotiations concluded, as respects the agreement that such a lease should be given?

Mr. Houpt: Was the agreement in writing?

Witness: I couldn't state as to that.

Mr. Houpt: I object, if it was not in writing, because a verbal lease would be void through these negotiations, if the agreement was stipulated to by word of mouth.

A. To the best of my recollection now, the terms of the lease were substantially agreed to along in the early summer of 1906.

Q. I stated to the court that my understanding was that those negotiations were concluded prior to the filing of these articles. That was my understanding. May be I am mistaken.

A. My own recollection is that that would not be quite correct, but substantially they were agreed to prior to that
69 time. But, it seems to me it was some time since then, I wouldn't like to say they were definitely agreed upon, but they were substantially agreed to by the middle of the summer of 1906.

Q. I believe you testified that one condition of these negotiations was that a corporation should be organized which could give a proper lease of this property.

A. That was one of the requirements.

Q. Since that time have any of these corporations executed mining leases, or have any mining leases been executed by any or either of [th-se] corporations? A. None.

The Court: That is the only lease that they made?

Witness: That is the only lease that any of these companies made.

Q. At the time of the organization of these corporations in 1906 in what did the value of the lands conveyed to the corporations consist?

A. The value consisted entirely in what might be under the surface, and not above it. The title which Messrs. Longyear & Bennett had in their half did not cover any timber. The timber at the time of the incorporation had been stripped from the land. They were deemed to be, most of the land, save and except this in the Sutton Company, valuable only for iron, and no value in addition to that has accrued to them since.

Q. Had the land at that time any appreciable surface value for agricultural or other purposes?

70 A. Most of them have not. A large portion of them, in fact most of them are covered with boulders and drift; that is, the larger portion of them.

Q. After the organization of these corporations I believe you said that the lands were conveyed to these corporations by these various heirs. Is it true that after the arrival of these heirs at their majority, or when they were out from under the tutelage of the court, they gave their confirmatory individual deeds?

A. They are all of age now. They did all confirm to the corporations their deeds.

Cross-Examination

By Mr. Houpt:

Q. I understood you to say that Snyder & Gale have been the attorneys of these three corporations during that entire period. A. Yes, sir.

Q. Do you receive a regular salary as attorneys for the corporations?

A. For the years I think ever since the inception of the companies, we have received a salary of $250 each from each company to cover our office work, or ordinary work, but not any extraordinary work that might come up.

Q. On that outside of routine work, you were paid special fees for. A. Yes.

Q. I understood you to say that you participated in the organization [you-self] of the corporations? A. Yes.

Q. The organization of these corporations was deemed
71 to be of a good deal of value and importance to the holders of this property.

A. I think that under my statement it is apparent that we had to have something that—

Q. It was deemed of importance?

A. It was certainly deemed of importance.

Q. Both important in handling the property with more expedition, and with more harmony, and also in making leases of the property.

A. If anything would require signatures.

Q. You couldnt deed any of this property without signatures? A. No.

Q. It was also of importance in the execution of mining leases? A. Yes.

Q. You could make a better lease? A. Yes.

Q. That is, you could make a better lease through a corporation than you could by the individuals, so long as some of the individuals were minors, the individual holders?

A. I [wouldn-'] say that you could make a better lease, because in each case when it came to the giving of guarantees the lease went through.

Q. Did you not state that under the laws of Minnesota, when the property of a minor was involved, you were restricted to making a lease not exceeding 25 years?

A. Yes, and I also stated that when the question came up of giving a guaranty, that the lease went through, and that they subsequently obtained a confirmation of the lease.

Q. Was there not some difficulty in giving a lease to
72 the Great Northern?

A. They wished a corporation lease, undoubtedly, as I said before.

Q. So that the object of the incorporation was because there were certain things of importance and of value to these property holders in the corporate form?

A. I will stand on my general statement of why they were incorporated, as given in my direct examination.

Q. How many leases are there outstanding?

A. There is the Monroe lease, the Glen lease covered by the Kearsage Company. There is also what we call the two Adams Leases in the Sutton Company. The Little Pearce was in the Kearsage Company also, but that is worked out. That is not outstanding, it is worked out. There are two Adams leases in the Sutton, and then there is the Longyear lease and the Little Chemung lease. There is the St. Paul lease, that is covered by the Sargent in addition to the Van Buren. There is also the Sargent Company. The Little Alexander mining lease, I think that was worked out before the incorporation, if it was not in the Sargent.

Q. I only intended to direct your attention to the leases in life. A. Yes.

Q. Then in the Sargent company there was the St. Paul mining lease and the Van Buren which are in existence?

A. Yes.

Q. Under which you are operating?

A. Yes, sir. There was the Big Chemung, the Little Chemung, but the Chemung is the name of the mine from
73 which we are receiving revenue.

Q. Is ore being extracted from the Monroe lease?

A. Yes, sir.

Q. And from the Glen lease?

A. There has been a large amount, but very little at the present time.

Q. From the two Adams leases? A. None.

Q. None [frome then] two Adams leases? A. No.

Q. You have received advance payments on them?

A. Yes.

Q. But none of the ore has been removed?

A. No ore has been taken out.

Q. The Longyear lease, how about that?

A. There has been some ore taken out, but nothing this year, I believe.

Q. Have you received advance payments on the Longyear mine? A. Yes, sir, in the past.

Q. How about the Chemung lease? A. There is no ore being mined.

Q. Has there been any ore mined? A. No.

Q. How is the St. Paul lease?

A. There has been ore taken out underground, and stripping ready to take ore out. Open pit.

Q. But ore has not yet been mined?

A. Yes, ore has been mined underground.

Q. Have you received advance payments on that ore?

A. Yes.

Q. The Van Buren leases, how is it as to them?

A. Advance payments. No ore mined.

Q. Do your records show the amounts of money paid on each one of these leases? A. They do.

74 Q. Since 1909? A. Yes.

Q. Do your records also show the proportional amounts paid on advance payments, and also for ore mined? A. Yes.

Q. Of course you can't state these amounts?

A. No, I can't state them but Mr. Bennett can state them. He is familiar with the books.

Q. It was stated here that [that] you bought 40 acres of land which was designated as the Day 40. A. Yes, sir.

Q. This tract of land or a portion of it was platted as a town site. A. Never platted.

Q. It was not platted? A. Never platted.

Q. No portion of it? A. No.

Q. You have platted though a portion of this land as an addition to Hibbing. .

A. No, that was platted years ago by the Pillsburys. Pillsbury's First Addition to Hibbing was platted. When we took the property over into the corporation these lots went into the corporation.

Q. Was there not a Second Addition to Hibbing platted?

A. No.

Q. In other words, there has been no land platted then by either of these corporations?

A. The Sargent Company, I can't tell. Mr. Bennett can tell better than I can. We have a Keewatin plat in the Sargent Company, but whether that was platted before the incorporation, or just after, I can't say.

Q. The Secretary's books will show that?

A. Yes, sir, the secretary's books will show that.

Q. These lands were all divided into 40 acre tracts.

75 A. Government subdivisions, whatever they have been.

Q. Were they not handled and listed by the Pillsburys, and since [since] by the corporation in 40 acre tracts?

A. I think they are carried on their books in that way.

Q. So there were ten thousand acres, or about ten thousand acres included in these three corporations?

A. Yes, about that.

Q. And that would mean about 250 forty acre tracts, would it not? A. About that.

Q. Are you able to state the number of tracts embraced by each corporation?

A. I am not. But the records and books disclose all the resolutions accurately. The resolutions can be offered.

Q. Do you know of any of the 40 acre tracts that are included in the Sargent Land Company that revealed iron at the time of the incorporation?

A. No. I cannot answer that.

Q. That information then would be more accurately obtained from Mr. Bennett.

A. I think he can give it to you more accurately than I can.

Q. Have explorations for iron been continued since the incorporation? A. Yes.

Q. Have such explorations been prosecuted since the years 1909, 1910 and 1911? A. By the lessees, Yes.

Q. By the lessees? A. Yes.

Q. But none by the corporations? A. No.

76 Q. Are all the lands leased?

A. No, not quite all. They did not select all. But we have not conducted explorations since. Whatever exploration has been done has been done by the lessees, the Great [W-stern] Mining Company.

Q. Then there are some lands held by the Sargent Land Company that have not been explored? A. Yes.

Q. Does the same situation exist with reference to the Kearsage Company?

A. No, they are leased. The Monroe mine and the Glen mine and the Pearce mine cover that.

Q. The lands in the Kearsage Company then have all been explored for iron? A. Yes, sir.

Q. What is the situation as to the Sutton Company?

A. There are a great many acres in the Sutton Company that have never been explored, and never will be explored, because they lie outside of [thr] range.

Q. This ore is removed under these leases under or upon a royalty basis, as I understand. A. Yes.

Q. How do you determine the amount of royalty that you are entitled to receive?

A. Each lease fixes the minimum that they must pay for mining in such case.

Q. How do you satisfy yourselves, or how does each company satisfy itself that on all of the ore mined the royalty on it is actually paid?

A. We have organized for that purpose a corporation known as the Meriden Mining Iron Company, with its office at Hibbing, Minnesota.

Q. That company is the agency then of these three

77 other companies?

A. That company by employment for our other companies determines any facts that we wish to know relating to our properties.

Q. It is your agent then?

A. We employ the company for that purpose.

Q. For looking after your corporation affairs?

A. Yes, because we couldn't do it ourselves.

Q. What individuals constitute that company?

A. That company has for its corporation the same as the Kearsage Company, the same stockholders.

Q. And the Kearsage Company has at least some of the same officers which these three companies involved in this suit have? A. Yes.

Q. And some in addition, as I understand, in the Kearsage?

A. No.

Q. Who are in the Kearsage company who are not in these three companies involved in this suit?

A. Mr. Frank Carleton and Mrs. Townsend are the only stockholders in the Kearsage Company who are not stockholders in the Sargent and Sutton Companies..

Q. Mr. Longyear is a stockholder?

A. Mr. John M. Longyear of Marquette, Michigan is.

Q. What is this Mr. Longyear?

A. Mr. Edmund J. Longyear. That refreshes my memory upon a point which I would like to cover, which I overlooked.

78 Mr. Edmund J. Longyear is engaged in the exploration of iron properties. He has a very large number of drills. He is related to Mr. John M. Longyear. In the middle nineties, about 1896, I can't give the exact date, the Pillsbury and Bennett interest made a contract with Mr. Longyear for the exploration of these lands, he to receive going rates for the drilling, and at the end to receive 3 per cent of the proceeds from ore discovered by his work. The contract followed the titles into the corporations.

Q. That is Mr. Edmund J. Longyear?

A. Yes, sir, Mr. Edmund J. Longyear.

Q. Mr. Edmund J. Longyear is not a stockholder in any of these three companies?

A. No, sir, he is not a stockholder.

Mr. Van Derlip: Let me correct that. He does hold one share in each one of the companies, so that he may represent Mr. John. M. Longyear legally.

Court here took a recess until two o'clock p. m. the same day.

Mr. Van Derlip: Before I call Mr. Snyder as a witness, Mr. Houpt, I intend to call your attention to what I am sure was an oversight on your part in your answer. The complaint alleges, among other things, beginning with paragraph, 3, the incorporation of the plaintiff companies, and at the end of the same it alleges that the companies were not organized for profit and are not liable to pay the tax. In the answer all the allegations in paragraphs one two and three are admitted.

79 It is agreed between counsel, with the permission of the Court that the answer may be amended as to the allegations in the latter part of paragraph 3, of the complaint.

Cross-Examination

By Mr. Houpt:

Q. You stated this morning that the Meriden Iron Co. had been employed by these corporations to look after their affairs.

A. On the range.

Q. Among other duties which they engaged to perform was that of supervising the taking out of the ore, in order that you might know what you were receiving your proper [rpyalty.]

A. That is true.

Q. Was that arrangement made in writing?

A. No. Let me explain about that. The Meriden Iron Co. was organized in 1903, by Mr. Bennett and Mr. Longyear for their use, but it lay dormant until 1905, and was not actually used. In 1905 this Pearce mine came back to the Pillsburys by reason of a forfeiture; they claimed that they had mined out all the ore and surrendered the lease back. We were convinced that they had not taken out all the ore, although they had bored round and injured our property. So, considering all these various interests we had to deal with, we thought it was best to organize the Meriden Company and let them take a lease upon the Pearce property, and see if we couldn't recover something out of it. So this corporation was used and stock
80 issued. And it never having been used before, and no stock having been issued, Bennett and Longyear and the Pillsburys made a lease to the Meriden Co. and that company started to operate and did operate and took out all the ore that was left. They found considerable ore. The Meriden Co. does business for anybody who may come. It has done business for people in Minneapolis and St. Paul. That was the organization of the Meriden Co.

Q. The Meriden Iron Co? A. Yes, sir.

Q. It was organized in 1903?

A. Yes, sir, through Mr. Longyear; my recollection is E. L. Longyear and Russell M. Bennett. I don't remember who the others were.

Q. Were any of the Pillsburys interested in it?

A. No.

Q. Or any of the Pillsbury heirs?

A. No, not at the time of the inception.

Q. It was Longyear and Bennett?

A. E. J. Longyear and Mr. Bennett came together with representatives the Pillsburys when it was a dormant corporation;

they permitted this one to be used. It remained dormant from 1903 to 1905.

Q. Then you revived it?

A. It was put into operation then.

Q. It was put into operation for the purpose of taking a lease of this Pearce mine? A. Yes, sir.

Q. Where the former lease had been abandoned? A. Yes

Q. Was it reorganized in any form at that time?

A. No.

Q. The same stockholders?

A. No. New stock was issued. The stock was issued at that time.

81 Q. Was stock at that time issued to the Pillsbury heirs?

A. Part of them, yes.

Q. That is, all the heirs who were interested in that property? A. Yes.

Q. Then when did you make your arrangement with the Meriden Iron Co. to look after the affairs of that corporation?

A. Just as soon as any question came up on any of our properties, relating to mining.

Q. Do you remember the date?

A. No, I can not tell you; but our general superintendent Mr. Warren is here, and I presume he can give you the date exactly when it was that he was instructed to look after that [arra-gement.]

Q. You say that arrangement was not embodied in any writing. A. No writing.

Q. Would that appear upon any of the books of the three corporations?

A. I have no recollection of such a thing. If there is the books will show. He was to look after it and render monthly bills, and we to pay the bills every month.

Q. Was that company authorized to make leases for the company? A. Oh, No.

Q. Did it pay the taxes upon your property?

A. Never, save and except the leasehold which it had. It was obliged to pay on their leasehold of the Pearce property. That was one of the conditions of the lease.

Q. I an speaking of the service that the company was

82 to perform for your company. You may state the services that that company was to perform.

A. For instance, we instructed the Meriden Co, through Mr. Warren to at once put either himself or a subordinate inspector upon that property, to see that it was opened in accordance with good engineering, and to test the ore as it came up, and check the shipments from the property, and to render monthly statements of the expense for that business.

Q. Did that company collect royalties?

A. No. It simply rendered monthly statements of the expenses.

Q. It rendered you statements of the royalties due.

A. No.

Q. It rendered no statements of royalties?

A. No, it rendered no statements of royalties. They simply stated the amount of ore shipped. That was a check against the railroad statements. That was all it amounted to.

Q. What compensation did you pay for these services?

A. We paid whatever bills he rendered for his services. There was no fixed amount. He rendered statements every month.

Q. Was a statement rendered to each one of these companies? A. Every one for whom they did work.

Q. During those years who was the executive head of the Meriden Iron Co.?

A. General superintendent O. B. Warren of Hibbing.

Q. Did you employ on behalf of the three corporations any other person to look after their affairs?

83 A. No, we considered Mr. O. B. Warren the best engineer whose services could be obtained. He was with the Meriden Iron Co., We employed that Company to get his services.

Q. You employed the Meriden Iron Co. and it employed Mr. Warren? A. Yes.

Q. About this Van Buren mine, that is one of the large leases.

A. That is the biggest lease. It included the most land.

Q. The greatest amount of iron.

A. Yes, as far as we know, all the iron bearing land in the Sargent Co. outside of their leases.

Q. They received advance royalties under that lease?

A. Yes.

Q. That was made what year? A. January 2, 1907.

Q. No ore has been removed under that lease?

A. No ore removed. They had a right to take out ore from the mine.

Q. Have the Van Buren people surrendered their lease?

A. Not yet.

Q. Has there been any corporation organized to take over the lease? A. Not to my knowledge.

Q. This Keewatin Co., that has been organized? A. Yes.

Q. Who [constitute-] the Kewatin Co.?

Objected to as immaterial because that company was organized after the period involved in this suit, with a view of conducting certain operations in the future, after 1915, and was not conceived until after 1911.

The objection is overruled.

84 Q. When was the company organized? A. In 1912.

Q. Was not the Kewatin Mining Company organized for the purpose of taking over this Van Buren lease? A. No.

The Court: I will rule that out. I do not see how it is material; it was after 1911.

Redirect Examination

By Mr. Van Derlip:

Q. You have stated that the Meriden Iron Co. was organized originally by Mr. E. J. Longyear and Mr. Bennett and some one else, for personal purposes, that after its organization no stock was issued, and that the corporation did not become an active company until 1905, prior to the organization of these three companies? A. Yes, sir, that is true.

Q. When the lease of the Pearce mine was surrendered, then with a view of having what ore there remained cleaned up and removed, the Pearce property was leased to the Meriden Iron Co.

A. Yes.

Q. As a lessee from the individual owners of the property.

A. Yes, that is true.

Q. Well, was this lease still in force when these properties were conveyed by the Pillsburys and by Messrs. Longyear & Bennett to these corporations? A. Yes.

Q. They took the lands subject to that lease? A. Yes.

Q. You started to say something about the nature of the business of the Meriden Iron Company, what business generally did it carry on?

A. The corporation was organized for the purpose of
85 mining ore and superintending mines, and doing anything in relation to mines generally; that is what it has done ever since it was incorporated; not for any particular property, not for this property, but for outside corporations.

Q. Has it been employed by the plaintiff corporations here, the same as they would employ any other corporation?

A. Yes, just the same. It simply was because it had as its head an engineer in whom they had great confidence that they employed this corporation, because it employed Mr. Warren.

Q. Was that company employed because it employed Mr. Warren?

A. Yes, that is absolutely true. It was employed because they wanted the services of Mr. Warren.

Q. Is it a fact, or is it not a fact, that the Meriden Iron Co. is doing and has done similar work for corporations and individuals entirely disconnected with the plaintiffs, to that which it has done and is now doing?

A. It certainly has. I can give you numerous instances if you want them.

Q. For instance, what patrons has it besides these plaintiffs?

The Court: I do not see how that is material, I understood that the general purpose of Mr. Houpt was to show that these land companies were doing business, and that to get at the amount of ore and look after it, they employed this Meriden Iron Co. instead of employing some individual.

Mr. Van Derlip: I suspect that Mr. Houpt intends to go further than the suggestion of your Honor. That he in-
86 tends to claim that because the Meriden Iron Co. is controlled by some [individduals] who are stockholders in the Kearsage, that this Meriden Co. was used as a stalking horse to cover up the actions of these corporations.

The Court: Do you make any point upon the question of the same persons being interested in the Meriden Co. who are interested in the Kearsage Co.?

Mr. Houpt: No.

The Court: Then I will sustain the [obj-ction].

Counsel for plaintiffs excepts to the ruling.

Q. You stated that some of the lands of the Sargent Co. had not yet been explored, what lands did you refer to?

A. I referred to lands of the Sargent Co. not selected by the U. S. Steel Co. as probable iron bearing lands, when the big lease was made. Lands which lay either north of the north boundary line of the new range, or south of the south boundary line, which we considered barren of ore, and of no value for iron purposes.

Q. They are not lands which the corporation is reserving for future exploration and development? A. No; not at all.

Q. As mineral lands? A. No, not at all.

Q. Is it not a fact that the iron formation on the Messaba Range is very distinctly defined?

A. Geologists say that it is very distinctly defined on the north by the outcropping quartz, beyond which there is
87 no iron ore. The south boundary line is defined by what is called "slates", which is not so accurately defined as the north line. But it is recognized as defining the south line.

Q. At the south line, the slate formation, no ore is found?

A. No ore is found.

Q. Is it or is it not a fact that the lands belonging to [th-se] plaintiff companies which are now within the limits of the iron formation, have been explored?

A. To my knowledge, they have all been explored. There is no hope for any thing in addition to what has been shown by exploration.

The Court: That explored land is now under lease?

Witness: Yes, sir, it is under lease.

Q. Since January 2, 1907, have these plaintiffs, or any of them, conducted explorations, or done any other work of exploration or development on any of their respective lands?
A. They have not done any exploration work. They did a little in 1912, but nothing prior to that time.
Q. But during the years that are in question in this case?
A. None whatever.

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88 RUSSELL M. BENNETT, sworn on behalf of plaintiffs, testifies as follows:

Examination-in-Chief

By Mr. VanDerlip.
Q. You are the Secretary and Treasurer of the plaintiff corporations. A. I am.
Q. And have been such since their organization?
A. I have, yes.
Q. After the filing or publication of te Articles of Incorporation of these companies, when was the first meeting of the stockholders held for the purpose of organization?
A. The meeting was called in May, but it was adjourned until July.
Q. What day?
A. The first meeting of the directors was May 15 1906, and it was adjourned until the 19th day of July, 1906.
Q. Was that true of all the corporations?
A. Yes, sir, all three of them were adjourned until that date.
Q. The day in May to which you refer was the date named in the articles for the first meeting? A. Yes, May 15th.
Q. They were not ready for organization then, so it was adjourned until the 19th of July. A. Yes, sir.
Q. Are you familiar with the history of the Meriden Iron Company? A. Yes, sir, I am.
Q. Did you hear Mr. Snyder's testimony in [relation] to it?
A. I did.
Q. Was that testimony correct, according to your knowledge and recollection?

A. That is substantially correct. The company was organized by Mr. E. J. Longyear and myself. I forget for what
89 purpose, but we [didn-t] use it. It lay dormant until 1905 when this question of operating the Pearce mine came up, and we utilized it for that purpose.

Q. The first stock issued by that corporation was issued at that time? A. Yes. In 1905 I think there were 108 shares, may be 100, I think 108. The authorized capital of the Meriden was $25,000, and there was $10,800 of it issued.

Q. You issued 108 shares representing each the 108th interest of the various owners of the property, the individual owners? A. That is right.

Q. Since that time the corporation has conducted the general business stated by Mr. Snyder. A. Yes.

Q. The employment of that company by the plaintiff companies in this case was for what purpose and reason?

A. As this property was leased and opened up, it became necessary to have an inspection, to see that it was opened up according to good engineering methods.

Mr. Van Derlip: I am going to ask a question which refers to a document in writing, and I will produce the document later.

Q. Was such inspection made to ascertain the amount of ore that should be removed under the rule provided for in the lease?

A. Under the general provision that the ore should be mined according to good engineering methods, and that there should be no unnecessary waste.

90 Q. There was authority expressly given to the lessor to enter upon the property, for the purpose of seeing that the provisions were carried out?

A. For the purpose of inspection and seeing that the provisions of the lease were properly carried out, it became necessary, as I said before, for the lessors to see that the provisions of the lease were carried out and a proper inspection made. We employed Mr. Warren, that is, the Meriden Iron Company employed Mr. Warren as its general [superintednent] for the purpose of carrying out and doing the inspection work

Q. When you say the inspection work, you mean that kind of work, or this specific work?

A. That kind of work for our companies and for other interests that might desire services of that character. The Meriden Iron Company inspected the properties. At each mine a local representative was stationed of the Meriden Company, usually an engineer. It was found necessary in making sur-

veys. The mining surveys which were supposed to be furnished to us were usually six months and sometimes longer, behind, so they were of very little use.

Q. Were these surveys furnished you by the lessees?

A. The leases provide that a map and survey shall be furnished by the lessees.

Q. To the lessors?

A. Yes, sir; but they were so far behind in their work that we [didn-t] receive them in time to be of any benefit to us. So we found it necessary to have our own surveys. Our engineer made surveys and kept them up to date, and [do--] at
91 this time. So as mining operations progress, if we find any ore is being wasted, we know from the surveys if such ore is being wasted, and we so inform our lessees.

Q. Was that the purpose of employing the Meriden Iron Company, to get that information?

A. Yes, it was. We employed the Meride on Company, and it in turn employed Mr. Warren.

The Court: The local engineer at e as he employed by the Meriden Iron Company?

Witness: Yes, sir, by the Meriden Ir Company. The Meriden Iron Company rendered to us each month bills for the services of the local engineers and also for the services of Mr. Warren, and for such proportion of the overhead charges as were apportioned, to the number of days on which they were employed on our work.

Q. In other words, each month you paid for whatever services had been rendered by the Meriden Company during the preceding month? A. Yes, sir.

Q. Whether it was greater or smaller? A. Yes, sir.

Q. And you paid only for the actual work that was rendered?

A. Yes, sir. The months when ore was being shipped the expenses would be rather heavier, and in the season when they were not shipping they would be comparatively less. In some months there would be practically no service or expenses.

Q. The employment of the Meriden Company by the plaintiff corporations then, was not upon the ground merely
92 that the stock of the company, this $108,000, was held by those interested in the plaintiff corporations?

A. No, that was not a reason whatever.

Q. So that company was employed, as any other engineer or as any other engineering company might be employed, simply because it rendered efficient service.

A. Because we needed this inspection work, and they were prepared to do it.

Q. Let me inquire whether the plaintiff corporations or any of them had an engineering department or any employees who were capable of rendering them such services as these.

A. No, I think not. Mr. E. J. Longyear, who has been employed by the plaintiff companies, does drilling, work, and he is a drilling expert.

Q. But he is not in the employment of the companies?

A. No, sir.

Q. Have you had in your regular employ engineers or others to do work of that character? A. Never.

Q. When Mr. E. J. Longyear was employed he was employed the same as any outsider to do certain work. A. Yes, sir.

Q. He was not employed by the companies. He was simply a contractor to do certain work?

A. We employed him in our drilling work. He was paid so much a foot.

Q. He was not on a salary? A. No, sir.

Q. You paid him by the piece?

A. For whatever work he did, yes, sir.

93 Q. This employment of Mr. Longyear was prior to your incorporation and the plaintiffs'? A. Yes, sir.

Q. The corporation did not do any exploration since that?

A. He did some drilling for us in 1906.

Q. But since the 2nd of June 1907?

A. No. We have done no exploration work since July 1907.

Q. This is the Mr. E. J. Longyear that Mr. Snyder referred to as having under the contract a 3% interest in the sales of ore? A. Yes.

Q. That is an arrangement which was made by the individuals before this corporation was organized?

A. Yes, sir, it was made on March 15, 1907.

Q. You heard Mr. Snyder's testimony in relation to the devolution of the title to these lands from the firm of John S. Pillsbry & Co. to these corporations? A. Yes, sir.

Q. Was that statement true, or was it not true, to your knowledge?

A. That is true, yes, sir. I believe all his statements are absolutely true.

Q. After the incorporation of the plaintiff companies were the lands which have been referred to, and which are now owned by these corporations, except so far as they may have disposed of certain tracts, conveyed to the corporations?

A. They were conveyed immediately after the incorporation, in February, 1906, I think.

Q. I show you a record book being that of that Sutton Land Company, and direct your attention to the entries
94 made therein, beginning on page three. What is the date of that meeting recorded upon page 3 and the succeeding pages? A. July 19, 1906.

Q. Was that the date when the corporations were organized, and when the deeds for these properties were delivered and accepted by the corporations?

A. They were delivered and accepted on this 19th day of July, as the minutes show.

Mr. Van Derlip: I am perfectly willing, Mr. Houpt, that you should put into the record any part of these minutes that you desire; but I should prefer to encumber the record as little as possible; so I will offer certain portions, with the understanding that you may put in such further minutes as you [seee] fit, as making perfectly clear the titles and interests of the grantors therein. I would like to offer in evidence that portion of the minutes of July 19, 1906 of each of the plaintiff [corporstions] which are exactly identical, with the exception of the descriptions of the properties, contained in a certain resolution, and with the permission of Mr. Houpt I should like to offer a transcript of the same rather than to leave the books in the custody of the Court. I will not read the entire record, which consists of recitals relating to the titles to these properties from John S. Pillsbury & Co., down through the various interests which were acquired by the different Pillsbury heirs, to the time when the whole of these titles were conveyed by these heirs and by Messrs. Longyear & Bennett
to these corporations. This sets out at a greater length
95 that Mr. Snyder testified as to the provisions of the will of George A. Pillsbury, and the conditions of all these various estates through which these titles finally vested in the numerous heirs in the proportions stated. It consists of certain preambles reciting these things, and finally winds up with this resolution:

"Now, therefore, for the purpose of carrying out the desire and intention of all of said parties, and the object of the organization of said corporation, and for the purpose of subserving the best interests of the estate of said George A. Pillsbury, deceased, and of each and every one of said grantors, and of this corporation, it is hereby Resolved that the Sutton Land Company hereby approves and accepts the offer of said grantors, and agrees to take over and receive the title, property and estate in said real estate and property conveyed by such deeds, and each of the same."

Mr. Van Derlip: The preamble having described the deeds which were tendered to the corporation.

"Resolved further that the proper officers of this corporation be, and they are hereby authorized and directed to issue the entire capital stock of this corporation in payment for the respective interests of said grantors in said real estate and property described in, and granted and conveyed by said deeds; certificates for said capital stock to be issued to the following named persons in the respective proportions
96 and amounts hereinbelow specified, to-wit:

Mr. Van Derlip: Then follows a detailed statement of the names of the grantors of those to whom the certificates shall be issued and the amount of each certificate.

It was provided, among other things, that there shall be issued to John M. Longyear 539 shares, to Edmund J. Longyear one share, to Russell M. Bennett 538 shares, to Norman C. Richardson one share, to John R. Van Derlip one share, said certificates together making 27/108ths of the capital stock to which said Russell M. Bennett is entitled. Then follows

"And said officers are hereby further authorized and instructed to deliver the same to said persons upon the vesting in said corporation of an indefeasible title to said lands by the delivery of the deeds above referred to, and of any other or additional deeds of conveyance that may be required or proper to effectuate the vesting of such title."

Then follow recitals in regard to these minors, and a provision by which the certificates of shares issued in their names shall be held in the office of the corporation until they shall attain their majority and shall [makes] deeds in conformity. to Schedule "A."

I offer in evidence this record of the meeting of July 19, 1906, and ask that it may be marked Exhibit 1.

97 Counsel for defendant objects to the introduction of Exhibit 1, on the ground that it is simply encumbering the record, that the testimony as to these titles and how they passed to the stockholders will not be contested, and that the real question is whether these corporations were engaged in doing business within the meaning of the tax law.

The Court: I think that the resolution is competent evidence. While the recitals are not evidence to prove these facts, yet I think it is competent to introduce the whole resolution for the purpose of showing how the devolution of title originated. I will overrule the objection.

Counsel for defendant excepts to the ruling.

Mr. Van Derlip: Will it be stipulated that one of these exhibits will suffice for all three companies?

Mr. Houpt: Yes, sir.

Mr. Van Derlip: We have here and can offer in evidence the specific deeds, but I suppose you do not question our ownership.

Mr. Houpt: We do not question your ownership.

Mr. Van Derlip: Then it may be admitted in the record that the plaintiffs under the deeds referred to in Exhibit 1, obtained title to the lands now held by them, with the exception of the Day 40?

Mr. Houpt: Yes.

Q. Mr. J. M. Longyear is not a resident and never has
98 been of the state of Minnesota.

A. No, he is a resident of the state of Michigan.

Q. Who has looked after the interests of J. M. Longyear and R. M. Bennett in this property now owned by the plaintiff corporations?

A. I have looked after Mr. Longyear's interests, with the exception of the representation that Mr. E. J. Longyear has in the board of directors of the three corporations.

Q. Have you been actively engaged in that?

A. I have been actively in charge of the business.

Q. Did you represent the interest of J. M. Longyear and Russell M. Bennett in the negotiations leading up to the organization of these corporations? A. I did.

Q. Speaking broadly, was the purpose which was stated by Mr. Snyder in his testimony this morning the real purpose of the organization of these corporations?

A. Mr. Snyder's testimony covered the facts.

Q. And was it true? A. That was true, yes, sir.

Q. Since the organization of these corporations in July, 1906, what if any business have they done?

A. They have not transacted any business, as I understand it. We leased, signed a lease on January 2, 1907 to the Van Buren Company of certain lands. This lease had been negotiated for, and practically everything determined by the autumn of 1905. In February, 1906, about the time the company was incorporated, the terms of the lease from the Sargent Land Company to the Van Buren Company were all of them
99 [det-rmined] upon, with the possible exception of the exact minimum which should go to the Sargent Company. That was decided upon later, in the summer or in the fall, I am not sure which.

Q. The execution of that lease on January, 1907, was then in pursuance of negotiations which had originated and been practically concluded in the fall of 1905, was it not? It was practically concluded at that time, before the organization of the company.

A. It was practically concluded in February, 1906 January or February.

Q. In February, before this corporation was organized?

A. Before it was completed, yes, sir, before that.

Q. Is it or is it not a fact that the organization of this corporation was one of the conditions for the lease to the Van Buren Iron Mining Company?

A. Yes, sir. The titles were in such shape that the Van Buren Company was quite insistent that we incorporate, so that we could make a perfectly valid lease. There had been a good deal of question raised in previous years in making leases as to the titles to these lands. They were so complicated by the deaths of Mr. George A. John S. and C. A. Pillsbury.

Q. Are you aware of any business which has been done by these corporations since the time of their organization, with the [excpetions] that you referred to, if you call that business, about the execution of that lease on January 2, 1907?

A. No, sir. No business has been transacted of any kind.

100 Q. Have these corporations, or has any of them, since the time of its organization, ever engaged in any business of any kind that has made a profit, or looking to make a profit?

A. No, sir; they have not.

Q. What disposition has been made of the receipts of these [verious] corporations from any source?

A. After paying expenses incidental to the [mmaintenance] of the corporations, the money has been paid out in dividends, or in liquidation of the assets of the corporation during the period which the statement covers.

Q. To whom were these payments made?

A. Made to the stockholders of the various corporations.

Q. In what proportion?

A. In proportion as their interests appear in the record.

Q. Has the company at any time carried any surplus for investment or otherwise?

A. No, sir; not in the years 1909, 1910, or 1911.

Q. Has it made any investments?

A. Made no investments, no, sir.

Q. Whether with a view of making a profit, or otherwise?

A. None whatever.

Q. There was some reference made to the purchase of a 40 acre tract known as the Day 40. A. Yes, sir.

Q. Do you recall when that purchase was made?

A. That purchase was made on August 6th, 1906. The
101 negotiations for this land were begun in 1905, in December I think. The individual owners of the land had platted a town site known as the Keewatin town site. About the time of the platting, or shortly afterwards, Mrs. Laura Day who lives here in Minneapolis, through her brother-in-law Mr. Robinson, platted an adjoining 40 to the one the individual owners had platted, and were prepared to sell lots. In some respects that 40 was a better one than the 40 which we had platted, and, in order to prevent competition, I entered into negotiations with Mr. Robinson, I think it was in December, to purchase this land. We agreed upon the price, and some time along, I think it was in January, possibly February of the following year, in 60 or 90 days, and agreed to take the land; but in the meantime we had started our incorporation, and it was held until after these incorporations were completed.

Q. That is, the execution and delivery of the deed?

A. Yes, sir, the execution and delivery of the deed were held. The land was deeded to the company.

Q. Have the corporations purchased any other property of that sort since that time?

A. That was the only land that was ever purchased.

Q. At the time this land was turned over to the corporation in July, 1906, had any portion of that been platted into lots?

A. Yes, this town site of Keewatin had been platted.

Q. The Pillsbury Addition had been platted?

A. The Pillsbury Addition had been platted several years prior.

102 Q. So when the corporations acquired these titles they acquired them with the plats already filed in the proper office? A. Yes, sir.

Q. As lots, and not as acres? A. Yes, sir.

The Court: As to the Day 40, the deed of that was made to the corporation?

Witness: Yes, sir.

The Court: Did the corporation pay for it?

Witness: Yes, sir.

The Court: Where did the money come from?

Witness: It came from, I am not sure, but I think it must have been provided by the individuals, because we hadn't any other money. I think the individuals put up, the money. I

would have to look that up, before I testify about that. It might have been paid out of the proceeds derived from some of these leases; but the time was so short after the incorporation, I am really unable to tell.

Q. At the time of the acquirement of these Pillsbury lands, and by Pillsbury lands, I mean the lands that had originally belonged to the John S. Pillsbury Company, in what did their value consist?

A. It consisted entirely of mineral possibilities of iron, the mineral value from the iron ore.

Q. What was the nature of the land, the nature of the surface of these lands, speaking generally?

A. Some low land, the higher land was on the Messaba
103 Range. The surface is rolling and broken. The entire distance is glacial, covered with large stones and boulders.

Q. What timber had at one time grown upon this land, was that standing or had it been removed?

A. The larger part of it had been removed, but part of it had not been cut.

Q. Did that timber become the property of the corporations? A. No, sir.

Q. Was it reserved by the grantors?

A. It was reserved by the grantors.

Q. That is, by the Pillsburys?

A. Yes, sir, by the Pillsburys.

Q. Did Longyear & Bennett have any interest in that timber? A. No, not at all.

Q. The title which you and Mr. Longyear had was subject to the right of the grantors to remove the timber?

A. To remove what remained uncut.

Q. At the time these lands were conveyed to the corporation were there any mining leases covering any of them, which had previously been executed by the individual owners of those lands? A. There were several.

Q. Can you state to the court these leases and the parties?

A. I have a list of them here, I think.

Q. Have you in court here the original leases for the inspection of Mr. Houpt, if he desires to make one? A. We have.

The Court: These are leases now outstanding?

104 Witness: Yes, sir, now outstanding. The Alexander mine lease. Do you want a description of the land?

Mr. Houpt: Give the number of acres.

Witness: This is the S. W. of the N. W., the Alexander mine; the name of the lessee is the Republic Iron & Steel Company.

Mr. Houpt: I think these leases should be introduced in evidence.

The Court: Is this lease outstanding?

Witness: No, sir, it is not outstanding.

The Court: Is there any occasion for the leases that are outside of these years 1909, 1910 and 1911?

Mr. Van Derlip: No, I think not.

Witness: This was subsequently surrendered. The S. ½ of the S. E. ¼ of 35-58-21, St. Louis Co. Minn., known as the Mahoming. That is in the Sargent Company. I am speaking now of the Mahoming lease. The ore has all been paid for, and they have the right to use the surface for dumping purposes. Then there is the S. W. of the S. W. 35-58-21, St. Louis Co. Minn. The Chemung. The S. W. of the S. W. of 35-58-21, St. Louis County, Minnesota. Name of the lessee, the Chemung Iron Mining Company. Date of the lease April 10, 1901; term of the lease 50 years, date of expiration 1951. Royalty rate 25 cents a ton. Annual minimum 50,000 tons. Amount minimum $12,500. The St. Paul: N. ½ of the S. W. ¼, sec.
105 24 lessee Corrigan & McKinney Co.; date of lease Jan. 1, 1903, Term of lease 25 years; expiration of lease Jan. 1, 1928; royalty 35c a ton; annual minimum 150,000 tons, amount minimum $52,500. Longyear, N. W. ¼ N. W. ¼ sec. 5, and S. E. ¼ of S. E. ¼ sec. 6 80 acres town, 57 Range 20 St. Louis Co Minn. Name of lessee, Interstate Iron Co., date of lease Jan. 8, 1902, Term of lease 50 years, expiration of lease Dec. 31, 1951. Royalty 25c a ton, annual minimum 75,000, Amount minimum $18,750.

Van Buren Iron Co. leased certain lands in St. Louis and Itasca Cos. as per schedule attached, about 3,435 acres, date of lease Jan. 2, 1907, term of lease, indeterminate, can be surrendered Jan. 2, 1915, by giving two years previous notice. Royalties are as scheduled, and increase from year to year. The notice should be eighteen months, instead of two years. The royalty is on a sliding scale. The annual minimum payments were to be paid on the 20th of Jan. of each year for the preceding year. For the year 1909, 346,500 tons at the rate of 91.8c for the year 1910, 462,000 at 95.2c and for the year 1911, 557,500 at the rate of 98.6c.

Q. Does that recital cover all of the leases upon lands owned by the Sargent Land Co?

A. It does. We have the original of these leases, including the lease of the Alexander mine which has been surrendered.

Mr. Van Derlip. I will offer them in evidence with the understanding that only such parts of the leases shall be
106 included as the parties see fit.

Q. Are all these leases to which you have referred, with the exception of the Van Buren Iron Co. lease in substantially the same terms and condition?

A. They were on a common form, but they are not the same terms, because some of the royalties are higher. The conditions are the same. The descriptions of course are different.

The Court: They are here, and if Mr. Houpt wants to do so he can present them in his case.

Q. Will you now give us the information relative to lands belonging to the Kearsage Co.

A. The Pearce mine. That was exhausted last year, but was not exhausted in these years. It was cleaned up in 1911. That is the N. E. of the N. W. sec. 28, town 58, range 20; leased Oct. 1, 1905, to the Meriden Iron Co., term of lease 10 years, expiration of lease Oct. 1, 1915, royalty 25c, increasing royalty going up to a dollar per ton Jan. 1, 1910. There was no annual minimum.

Glen Mine S. E. of the N. E. ¼ and E. ½ of the S. E. ¼, 120 acres, sec. 29, town. 58, range 20, St. Louis Co. They are part of the Lake Superior Consolidated Iron Mines, the Oliver Iron Mining Co. Date of lease Jan. 1, 1900, term of lease 50 years, expiration of lease Jan. 1, 1950, Royalty 25c a ton; annual minimum 100,000 [tins]; amount of minimum $25,000.

Monroe Mine, S. E. of N. E. and E. ½ of S. E. sec. 28, town 58, range 20, St. Louis Co. Name of lessee Chemung Iron Co., date of lease [lease] March 5, 1900, term of lease 50
107 years, expiration of lease Jan. 1, 1950. There is no royalty rate; it was 25c a ton for Bessemer and 12½ for non-Bessemer ore. Then that rate was changed Jan. 1, 1913 to 15c per ton for all ore. Annual minimum 100,000 tons, amount of minimum $15,000.

That comprises all the Kearsage leases.

Mr. Van Derlip: We have the original leases if you desire to use them.

Mr. Houpt: Very well.

Q. Now please state the leases existing upon properties belonging to the Sutton Land Co., at the time of the acquirement of these lands by the corporation, and if any have been executed since that date.

A. [They] are only two leases outstanding of the Sutton Lands, and none have been executed since the formation of the corporation. They are the E. ½ of the S. W. ¼ of sec. 27, town. 58, range 20, St. Louis Co., Minn., and the W. ½ of the S. W. ¼ of sec. 27, town 58, range 20. Both of them run to John B. Adams, and have been assigned by him to the Arthur Mining Co. They are dated March 1, 1902, term of lease 50 years, expiration of lease April 1, [1852]. Royalty 25c a ton, Annual minimum 100,000 tons, amount of royalty $25,000 annually. That is in each case.

Mr. Snyder: I think the 100,000 minimum covers both leases.

Witness: Yes, that is right, 50,000 minimum in each
108 case.

Q. $12,500 annual minimum payment? A. Yes, sir.
Q. Have you now described all the leases existing at the time this property was transferred to the plaintiff corporations, and those that have been executed since that date?
A. I have described all of the outstanding leases.
Q. Do the plaintiff corporations receive any income from lands covered by these respective leases, beyond the amounts named in these leases as advance royalties, or royalties upon ore actually shipped?
A. There have been some town lots sold.
Q. That does not answer my question.
A. No, none whatever.
Q. Under the terms of the leases can these corporations receive any [or] other or different income than those specified in the leases themselves?

Objected to.

Objection sustained.

Q. Can the plaintiffs or can either of them receive any income from any of these lands covered by the leases which you have specified, other than the income derived under those leases? A. It can not.
Q. Do the plaintiff companies or either of them exercise any control or right over any of these lands covered by the leases?
A. They do not. They are out of our control. They are out of our use.
Q. Have they so been out of your control and out of your use since the dates of the respective leases?
A. Yes, since they went into force.

Q. Other than the disposition of ores under the leases which you detailed, have these companies sold or made
109 any other sales or disposition of ore on any of the lands belonging to them respectively? A. No; they have not.

Q. During the years 1909 to 1911 inclusive from what was the income of these corporations substantially derived?

A. From royalty payments and advance minimum royalty payments under the mining leases referred to.

Q. You say a few lots have been sold from time to time, and from these sales the companies have received some small amounts.

A. Lots have been sold, and receipts have been derived from those sales.

Q. Who controls the disposition of these lots?

A. The Longyear Company at Hibbing does the selling of the lots on a commission.

Q. Does any one of the plaintiff companies maintain an office or take any part in the sale or disposition of these lots or any other property?

A. No, sir. The lots are all sold by the E. J. Longyear agency.

Q. When did the E. J. Longyear Company become associated with this property as sales agent?

A. At the time the additions were platted.

Q. That would be prior to, the incorporation of these companies?

A. In the case of the Keewatin, and in the case of the Pillsbury addition, but the second addition to Chisholm I am not sure about.

Q. With respect to the lots known as Pillsbury's ad-
110 dition to Hibbing and the Keewatin addition or town site, Mr. Longyear was appointed agent for the sale of them before the organization of these corporations?

A. He was.

Q. But you are not entirely sure as to whether he was so appointed in the case of the Chisholm addition?

A. No, but I can look it up.

Q. Will you please look that up? A. Yes.

Then follow the usual items of attorney fees, Salary of assistant secretary and treasurer, stenographer's salary and taxes.

Q. Now I will direct your attention to the year 1910. Receipts from the Glen mine for that year. For ore mined and shipped, $104,168.57 from the Pearce mine, $8,758.36 for ore mined and shipped. The Monroe mine $14,338.70 for advance minimum payment. Then sale of lots $3,394.24 second addition to Chisholm.

Q. They were sold under the same arrangement?

A. Yes. Then there is interest $332.61, that is for interest on deferred payments on lots.

Q. The item of $3,396.03.

A. That is for inspection I think, no, registration expenses. Monroe mine expense $2,970.48, that is for inspection. General expenses $127.74.

Q. The item of $300 Pearce Addition to Chisholm, expense?

A. That was for the survey of the Pearce 40, so called, on which we conducted mining operations. The ore was about exhausted, and the Kearsage Company had planned to plat it. We surveyed it but the plat never was accepted by
111 the village council, and the whole thing fell through. It never was platted by the Kearsage Company.

Q. Also here are the usual items for your office force and attorney fees? [—.] Yes, sir.

Q. Now for the year 1911 how much were the receipts from the Glen mine?

A. $47,585.97 for ore mined and shipped. From the Pearce mine $84,123.51 from the Monroe $14,550 minimum royalty payments. Then there is an item of $301.34 for lots sold in 2nd addition to Chisholm, and an item of $46.63 interest received.

Q. Then disbursements, Monroe mine expense $3,065.30.

A. That is inspection.

Q. Glen mine expense $2,440.81? A. Inspection.

Q. Taxes and the usual expenses of the office force.

A. Correct.

Q. Concerning the Kearsage Land Company, I call your attention to your minute book for that company of April 30, 1909. What action was taken at that time authorizing the officers of the corporation to make test pitting on the N. E. of the N. W. ¼ of Sec. 28, [twon] 58, range 20?

A. There was a resolution passed. Mr. C. S. Pillsbury moved and Mr. E. C. Gale seconded a motion that the officers of the corporation be and they are authorized and empowered to prove by test pitting the N. E. ¼ of the N. W. ¼ of Sec. 28, township 58, range 20, and if no merchantable ore be found that the same be platted into blocks and lots. This is the Pearce 40 that I just referred to. This item of
112 $990.80 in the year 1909 for [for] expense of exploration is undoubtedly for that work.

Pursuant to that resolution test pitting was carried out, and was this item of $990.80 the expense incurred under that resolution?

A. Yes. [It] am very sure it is. We didn't carry on any other exploration. It must be that.

Q. Will you look that up and verify it?

A. Yes, sir. I have a memorandum of that.

Q. May 27th, [1919], what action was taken by the board at that time with reference to the Oliver Mining Company's lease?

A. There is a resolution pertaining to that. It was passed in connection with a dispute in the Glen mine over some ore, low grade ore, whether it should be mined out clean, or whether they should be permitted to cave it.

Q. By caving, you mean wasting it?

A. Yes, sir, wasting it.

Q. What is the resolution? A. Shall I read it?

Q. Yes, read it, please.

A. "Whereas the lease dated January 1, 1900 now held by the Oliver Mining Company, of the Glen mine, contains among others the following provisions: 'the said second party expressly covenants and agrees to mine out clean as it goes all of the ore in the mines or ore deposits opened on said premises, which shall assay 57% or upwards of metallic iron, without regard to the phosphorus contained therein, allowing only for usual and reasonable waste, it being the intention of the parties hereto and the meaning of this lease, that whereas certain of the iron ore underlying or upon the premises hereby leased is supposed to be richer in metallic iron
113 and lower in phosphorus than other portions of the ore upon said premises, the party of the second part shall not discriminate between any of said ores in their mining operations upon said premises, but shall remove as it goes the entire ore deposit which shall assay not less than 57% of metallic iron from the level or levels on which the mining operations are or shall be conducted, to the surface of the ore deposit.

"That all the earth, stones and other debris and waste excavated or removed in the process of exploring or mining, or in their working operations or improvements above authorized, shall be so deposited, and all the work and operations on said premises shall be so conducted, carried on and completed that the same shall not hinder or render dangerous or unreasonably inconvenient the future explorations of said premises for ores or [minreals], or the continuation of the operations or work of mining thereon, and in such manner only as is usual or approved by experienced and skillful miners, having [dur] reference to the future and the permanent value of said premises as an iron mine.

"Whereas the main part of the ore deposit in the Glen mine assays 57% and upwards in metallic iron, but has overlying

it a stratum of low grade ore mixed with decomposed slate, and paint-rock in that portion of the leased premises described as follows: "That area bounded on the north by the east and west line shown on the plan maps of the Oliver Mining Company and the Kearsage Land Company as the '400 N.
114 line,' it being 400 ft north of the Zero line, (the east and west centre line of section 22, township 58, range 20) and bounded on the south by the '250 S. line,' this line being 250 ft south of the Zero line, containing iron ore which this company believes will before many years become merchantable and constitute a valuable asset of the corporation.

"Whereas the Kearsage Land Company has employed Mr. O. B. Warren as its general superintendent, and had instructed him to carefully inspect the mining operations being carried on by the Oliver Mining Company in the Glen mine, and to require the lessee to mine all ore assaying 45% or over in metallic iron, wherever, by the mining operation of ore of that grade, if not mined when the ore containing 57% and upwards of metallic iron is mined, will be left 'unreasonably inconvenient' for the future mining thereof, and the value of the premises, as far as the ore is concerned, will be permanently destroyed as an iron mine;

"Whereas the Oliver Iron Mining Company claims that the structure and composition of the above mentioned statum of low grade ore is not suitable for furnace use at present, and is not merchantable;

"Whereas pursuant to his instructions Mr. Warren has required the Oliver Mining Company to mine and ship, and to conserve for the future benefit of itself, or of the fee owner, this overlying stratum of low grade ore;

"Whereas dispute has arisen between the representatives of the Kearsage Land Company and the Oliver Mining
115 Company as to the construction of the provisions of the lease hereinbefore set out, so far as they relate to the mining or conservation of the low grade ore hereinabove particularly mentioned;

"Whereas The Oliver Mining Company has notified the Kearsage Land [Compant] that it does not intend to mine any of the overlying low grade stratum of ore assaying less than 57% in metallic iron, save and excepting as it may choose to, and intends to take out the now merchantable ore underneath the same, and cave the overlying low grade ore, maintaining that

under the methods used by it, the low grade ore does and will fall substantially in a mass, and be conserved for future mining operations within the meaning of the lease, when such ore becomes of merchantable value;

"Whereas, on the contrary, the Kearsage Land Company claims that, by the terms of the lease, the lessee is obliged to so conduct its mining operations, as not to drop down and cave the stratum of low grade ore; asserting that said stratum of low grade ore cannot be conserved in any known method of mining engineering; that, if such stratum of low grade ore is undermined and left without support and caved, the body of low grade ore will be [total-y] wasted and lost; and that the Kearsage Land Company will suffer permanent damage.

"Whereas this corporation asserts that by the terms of said lease the lessee has no right to remove from said mine,
116 nor to waste (save and except with the consent of this company) any ore in said mine assaying under 57% in metallic iron;

"Whereas the Oliver Mining Company has given assurance to this company that if it is permitted to cave the overlying burden of low grade ore, it will, in all of the other mining operations on the Glen mine, mine out all ore assaying 57% and upwards of metallic iron in accordance with the terms of its lease, and especially in such a manner that 'all the work and operations on said premises shall be so conducted, carried on and completed that the same shall not hinder or render dangerous or unreasonably inconvenient future explorations of said premises for ores and minerals, or the continuation of the operation or work of mining thereon, and in such a manner only as is usual or approved by experienced and [skil-ful] miners, having due reference to the future and permanent value of said premises as an iron mine.

"Resolved that the Kearsage Land Company, with the aim of avoiding controversy with the Oliver Mining Company in the business relations which must continue to exist between them, hereby consents that the Oliver Mining Company may mine and remove so much of said overlying stratum of low grade ore, in that portion of the leased premises hereinbefore specifically described, as it may choose, and may cave the rest if said stratum with its overburden; and the Kearsage Land Company hereby waives its claim for damages accrued or to accrue from the caving of said stratum of low grade ore, without preju-
117 dice, however, to its rights to enforce the terms of the lease as to any ore in the mine, other than said overlying stratum, in the area of the leased premises above described,

assaying less than 57% in metallic iron; that the action of the Kearsage Land Company in consenting to the caving of said stratum of low grade ore, is to attach only to the Glen mine, and is not to be taken as a precedent in any future mining operations conducted by the Oliver Mining Company, under any of its leases from this company or with any of its associates.

"Resolved further that the Kearsage Land Company expresses its unqualified endorsement of the competent and thorough manner in which Mr. O. B. Warren has conducted his supervision of the Glen mine and regrets that the Oliver Mining Company has felt that there has been any occasion for any criticism of his methods;

"Resolved further that this resolution be spread upon the minutes of this meeting, and that a copy thereof be mailed by the secretary to the Oliver Mining Company and to Mr. O. B. Warren.

"The motion was seconded by Mr. Van Derlip, and was thereupon unanimously adopted."

"Whereupon the meeting adjourned. Signed R. M. Bennett Secretary."

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118 The following Exhibits were produced by counsel for plaintiffs, and marked as Exhibits in the case during the examination in chief of Mr. Russell M. Bennett.

Exhibit 1. Record of Directors' Meetings of July 19. 1906.

Exhibit 2. Report of Receipts and Disbursements of the Sargent Land Company for the year 1909.

Exhibit 3. The same as above for the year 1910.

Exhibit 4. The same for the year 1911.

Exhibit 6. Letter from Sargent Land Company to Frederick von Baumbach dated February 27, 1913 remitting check for corporation tax.

Exhibit 5. Return of annual net income by Sargent Land Company.

Exhibit 7. Same as to Kearsage Land Company.

Exhibit 8. Same as to Sutton Company.

Exhibit 9. Receipts and Disbursements Kearsage Land Co. 1909.

Exhibit 10. Receipts and Disbursements Kearsage Land Co., 1910.

Exhibit 11. Receipts and Disbursements Kearsage Land Co., 1911.

Exhibit 12. Receipts and Disbursements Sutton Land Co., 1909.

Exhibit 13. Receipts and Disbursements Sutton Land Co., 1910.

Exhibit 14. Receipts and Disbursements Sutton Land Co., 1911.

Cross-Examination

By Mr. Houpt.

Q. It appears from this [resulution,] as I caught it from your reading, that the Kearsage Mining Co. employed Mr. Warren directly?

119 A. Mr. Warren was employed by our company.

Q. Does not the resolution in express terms employ Mr. Warren?

A. According to the resolution it does, yes, sir.

Q. What page is that you were reading from?

A. Page 59.

Mr. Van Derlip: Mr. Houpt advises me that he is now ready to admit that the plaintiffs in these various actions made two applications for the abatement of these taxes, which applications were denied, and thereafter having paid the taxes it made two applications for the refundment thereof, which applications were also denied, all as alleged in the complaint.

Mr. Houpt: The facts are admitted as stated.

(Court adjourned until July 31, 1913 at 10 a. m.)

Q. I was about to direct your attention to the minutes under date of Sept. 28, 1909. It appears that you took some action at that time concerning the N. W. ¼ of 28-58-20. Did you by resolution at that time agree that that quarter should be platted into town lots?

A. It was moved by Mr. Charles S. Pillsbury and duly seconded that a portion of the N. E. ¼ of the N. W. ¼ of section 28, township 58, range 20, known as the Pearce mine forty, be platted into town lots, and that Mr. E. J. Longyear, be instructed to employ the Duluth Engineering Company to survey and plat the same; also that Mr. E. J. Longyear be secured as an agent to sell the lots on a commission of 10%.

Q. On what page does that occur?

A. Page 67, September 28, 1909.

Q. By the terms of that resolution Mr. E. J. Longyea
was employed by the corporation as its agent to plat
120 portion of this 40, and then to dispose of the lots.

A. Yes, the E. J. Longyear company. Mr. E. J. Long
year individually had nothing to do with it.

Q. But Mr. E. J. Longyear is mentioned individually in th
resolution? A. Yes, sir.

Q. Now I will direct your attention to the action of th
board of directors [und-r] date of June 29th, 1910. It appear
from my memoranda that a resolution was passed at that tim
amending the lease of the Meridem Iron Company, and increa
ing the royalty under the lease from 25c per ton to one dolla
per ton after January 1, 1910; have you such an entry i
your book?

A. Yes. Resolved that the proper officers be and they ar
hereby authorized and directed to execute and deliver an agre
ment dated December 31, 1909, with the Meriden Iron Com
pany, altering and amending a certain lease dated October
1905 made with said Meriden Iron Company, covering th
Northeast ¼ of the Northeast ¼ of section 28, township 5
range 20, St. Louis County, Minnesota, so that the rate
royalty to be paid on all ore mined and shipped from said min
shall be one dollar per ton instead of 25 cents per ton; sai
change to take effect as of January 1, 1910.

Q. Will you turn to the resolution of July 19, 1911 relatin
to the transfer of certain land contracts to the Meriden Iro
Company, and read that resolution.

A. Mr. Charles S. Pillsbury offered the following resol
tion: Resolved that this corporation, in consideration of th
sum of one dollar and other good and valuable consider
121 tions to it in hand paid, sell, assign and transfer unt
the Meriden Iron Company all of the following describe
pieces or parcels of real estate, situated and being in the 2
Addition to Chisholm, according to the plat thereof on file or
record in the [foffice] of the Register of Deeds in and for th
County of St. Louis and State of Minnesota, to-wit. Do yo
want me to give the numbers of the lots?

Q. Can you give the number of lots?

A. It is pretty hard to pick [then] out.

Q. By that resolution you transferred and intended to tran
fer to the Meriden Iron Company all of the lots which you ha
owned in that addition to Chisholm?

A. That was the intention.

Q. And also all contracts outstanding for the sales of lots

A. That was the intention. They were not transferred u
til 1912.

Q. The resolution was dated on that date?

A. Yes, sir.

Q. And they were transferred pursuant to that resolution?
A. Yes, sir.
Q. And the contracts transferred were contracts entered into between the years 1908 to 1910 inclusive?
A. 1908 and 1909. I don't think any in 1910, yes, there was one in 1910.
Q. Was that arrangement with the Meriden Iron Company entered into for the same purpose as you made the arrangement with John S. Pillsbury?
A. Only partially; that was one of the reasons. We wanted to transfer these lots anyway, because of the fact that the Meriden Iron Company had got an office in Hibbing, and
122 E. J. Longyear, who was the sales agent for those lots, had an office in Hibbing. It was to save, when sales were made, sending the deeds and contracts down to Minneapolis to be signed. We would have done that in any event.
Q. That transfer was made for the nominal consideration of one dollar? A. One dollar, yes.
Q. So the Meriden Iron Company only held the lots in trust, held them, for the benefit of the Kearsage Land Company?
A. The sale was not made, as I remember it, according to the resolution. There was a demand note given by the Meriden Iron Company to the Kearsage Company for $25,000. As fast as the lots were sold the money was endorsed on that demand note until it paid it.

The Court: As I understand it, the stockholders of the Meriden Iron Company are the same as the stockholders of the Kearsage Land Company.

A. Yes, sir, identically the same.
Q. Was that $25,000 the agreed value of the property?
A. It was the same valuation that was put on the lots, yes.
Q. Did that $25,000 limit and fix the amount that the Kearsage stockholders were to get out of these lots?
A. Absolutely. The amount of $25,000 was the amount that the Kearsage stockholders were to receive under that demand note.
Q. Then all the money in excess of that, would that belong to the Meriden Iron Company? A. Yes, sir.
123 Q. That was the compensation then for the Meriden Iron Company? A. Yes, sir.
Q. Whatever they received in excess of $25,000 for doing the business?
A. There would be some profit to the Meriden Iron Company in selling these lots over and above the $25,000.

Q. You say the profit over and above the $25,000 was t
compensation of the Meriden Iron Company for doing th
business?

A. Nothing was said about that. Presumably, the Merid
Iron Company would receive the profit for selling these lo
over and above the $25,000.

Q. Suppose there was not $25,000 realized out of the sa
of these lots, was the Meriden Iron Company to make that
then? A. Certainly, absolutely.

Q. You mean to say that the Meriden Iron Company was a
solutely bound for the sum of $25,000.

A. Bound for the same. Bound for the sum of $25,000
the demand note.

Q. The Meriden Iron Company's stockholders were identic
with the Kearsage [Company'd] stockholders.

A. The same holders exactly.

Q. So in this transaction, so far as gain or loss was co
cerned, it was similar to a man taking money out of o
124 pocket and putting it in another?

(Witness makes no answer)

Q. [Isn-t] it a fact that the main purpose in view in ente
ing into that transaction was to avoid the appearance of t
Kearsage Land Company doing business?

A. I think that would be the principal reason; but, as I sa
before, we would have made the transfer any way, just as
matter of convenience. We had discussed it, and had decided
do it.

Q. In all of these companies you held annual meetings
the [st-ckholders]. A. Yes, sir.

Q. It was the invariable rule at all of these meetings of t
stockholders to approve, ratify and confirm the action of t
board of directors for the preceding year.

A. It was customary. I think it was done in each year.

Q. I think you said you had no stated time for declari
dividends?

A. We would declare them when the the royalty payme
were made; they were made each month, and we usually held
meeting soon after the payment. For instance, if the royal
payment was due on the 20th of the month, we would hold
meeting about the end of the month. In the case of the V
Buren mine lease we held meetings four times a year, becau
the payments were due four times a year.

Q. The dividends paid by the Kearsage Land Company
the year 1909 were $111,240.

A. I am not sure. I would have to have [have] the ca
statement. Yes, that is the sum.

125 Q. For the year 1910 $123,120. A. That is correct.
Q. For the year 1911 $143,100. A. That is correct.
Q. I will now call your attention to the Sutton Land Company, beginning with the year 1909; what were the receipts and royalties for that year, which involves the S. W. ¼ of 27-58-20?
A. The receipts for, advance minimum royalty payments for the S. W. ¼ [27-58-2-] were $24,250.
Q. That means that there was no ore removed?
A. No ore removed.
Q. There is an item of timber sold that year, $1,490.
A. That was for [for] some hardwood timber that was on the land.
Q. Did the company have that timber cut?
A. No, I think they issued permits for cutting it. That is, they sold it under permits.
Q. That is, they sold the stumpage?
A. Yes, sir, they sold the stumpage.
Q. For that year there is an item of general expense of $110.22, and superintendent's expense $42.49, is that correct.
A. Yes, sir, that is correct.
[A.] Miscellaneous land expense $41.39. A. Correct.
Q. Taxes $439.34. A. Correct.
Q. Then there are the usual fees for office force, those expenses were incurred in about the same manner as you previously testified. Have you the itemized statement here of those general expenses, and also of the expenses charged against the property that I asked for [yestreday]?
A. Yes, I have a statement showing just what those
126 are.
Q. Now for the year 1910 did you receive the same amount of advance on ore?
A. The same amount, $24,250.
Q. The item of $570 timber sold, that is stumpage?
A. That is stumpage, the same as the other.
Q. Here is superintendent's expense, $111.21, miscellaneous land expense $66.51 and general expense $388.10.
A. That is correct.
Q. In addition to the regular fees for salaries of the office force. A. Correct.
Q. For the year 1911 the same amount for advances on ore.
A. Yes.
Q. For timber sold $500, general expense $473.59, and taxes $370.57? A. Yes, sir. That is correct.
Q. And the usual salaries for the office? A. Yes, sir.
The Court: No charge for supervision during that time?
Witness: No specific charge, if there is any it is under the general head of expenses $473.59.

Mr. Van Derlip: No active mining operations were bei
conducted on these lands at that time.

The Court: There is a charge in 1909 and in 1910 for supe
intendence.

Witness: That is our custom to survey our properties i
advance of their opening. That was for engineering duri
that period.

Q. Calling your attention to the action of the board of
rectors of the Sutton Land Company on April 30, 1909, it a
pears that there was some action transferring timber
127 the J. S. Pillsbury Company.

A. We desired to sell and dispose of the stumpage
some lands. It was moved by Mr. Carleton and seconded
Mr. Snyder that the officers of the corporation make a li
of the lands of the corporation, and place the same in the han
of the J. S. Pillsbury Company with authority to sell and d
pose of the stumpage on said lands through their agent M
Thomas Nary.

The motion was duly carried.

Q. The item of timber sold to which I called your attenti
was the produce of sales made from lands embraced in th
resolution? A. I think it was, yes.

Q. You may turn to the action of the same directors on I
cember 6th, 1910 concerning the Chisholm Street Railway ma
ter.

A. "Upon motion of Mr. J. S. Pillsbury a committee co
sisting of Mr. C. S. Pillsbury; R. M. Bennett and J. R. V
Derlip was appointed, with authority to negotiate with t
promotors of a street railway line between Hibbing and Ch
holm, with reference to passing over any lands belonging to th
[co-pany,] with full power and authority to act in behalf
this company in the premises. The motion being duly second
was unanimously adopted, and the chair declared the appoi
ment of the committee named in said motion."

Q. The dividends paid (Sutton) for the year 1909 were?

A. $22,140.

Q. And for the year 1910? A. $23,760.

[A.] And for the year 1911? A. $23,220.

Q. Referring again to the item in the Sargent Compa
128 for the year 1909, under the head of disbursements, th
is $2,927.20 for inspection; what items go to make
that aggregate?

A. I have not the items here, I did not know that you desi
them. I testified I think it was for inspection bills of E.

Longyear Company for inspection and drilling done about the Great Western Mining Company on these lands for that year.

Q. Have you the items entering into the general expenses of $2,518.35?

A. Yes, I have them. For the month of January 1909 premiums on bonds of the treasurer and assistant treasurer $55. Postage, light and telephone, stationery, etc. $20.93., totalling $75.93 Office rent, postage, light telephone, for January, February, March and April, $40.04, the same items for June and July $25.79; August stationery, 83; October registration of titles $358.66, November registration of titles $2,186 of the Sargent company lands, under the Torrens law. O. B. Warren, Expenses checking up records, $32,27, making a total of $2,721.69. Credit of refund Chisholm fire for subscriptions $203.34, making net $2,518.35.

Q. Have you the items that make up the aggregate of miscellaneous land expense $703.89 for the year 1910 for the same company?

A. No, I didn't make that, you didn't ask for it, we can get it for you.

Q. Have you the items constituting the Mine expense for the Glen Company for the year 1909, $5,064.95?

A. Yes, I have that. For the month of January the expense was $295.92 Superintendence, O. B. Warren, $108; in-
129 spection $50; engineering, $81.40, expenses $38; special expense $4.27. Hibbing office expenses, $23.40, amounting to $305.07. E. J. Longyear paid 3% of these inspection expenses. He has a 3% interest in the proceeds of the royalties and pays 3% as his proportion of the inspection expenses. Month of February, $377.42; superintendence, O. B. Warren $144; inspection $50; engineering $124.30; special clerical work $1.20; current expenses, $40, analysis, $4.40; Hibbing office expenses, $25.20, amounting to $389.10. 3% of that was paid by E. J. Longyear, which leaves $377.42. For the month of March, $439.50. Superintendence, O. B. Warren, $216; inspection, $104; engineering, $40.50; barn expenses, $34, analysis, 40c; special expense, $10.19; Hibbing office expense, $48, making a total of $453.09. For the month of April $696.02, Superintendence, O. B. Warren $252; inspection, $63.97; engineering, $162.47; special clerical work, 90c; travelling expenses, $7.84; barn expenses, $60; analysis, $1.60; special expense, $2; Hibbing office expense, $56; making a total of $606.78. 3% paid by Mr. Longyear $18.20 making $584.58. I have the items of the test pitting that was done on this Pearce 40,900 and some odd dollars. Glem mine for the month of May; superintendence, O. B. Warren, $210; inspection, $61,01; engineering, $180.72; special expense, $11.40, barn expense, $42; analysis,

$5.60; special telephone expense, $3.37; special expense, $2.48; Hibbing office expense, $40; total $566.58.

130 The Court: Is there any necessity for going through all these months. Is it true that the items for the balance of the months of the year run for the same class of work in each case?

Witness: Yes, sir, about the same in character all the way through.

Q. And the same would be true for the years 1910 and 1911 for the same class of disbursements?

A. Yes, sir, the same character.

By Mr. Houpt:

Q. These expenses were made under your leases for the protection of your interests in those mines?

A. They were made on account of the inspection work.

Q. You have a charge for analysis, that was for analyses of the ore?

A. For analyses of samples that were taken during the inspection work.

Q. Under these leases do the royalties vary according to the richness or the leanness of the ore?

A. The royalties are a flat royalty in every case.

Q. What was the purpose of making the analyses then?

A. To determine whether the ore would be merchantable or non-merchantable.

Q. Whether it should be mined?

A. Whether we could insist upon its being mined, or whether it should be wasted.

Q. If below a certain percentage it is wasted, and if above it is considered merchantable?

A. Yes, when it was merchantable it must not be wasted. When the ore becomes merchantable we insist upon their conserving it if it can be done according to good engineer-

131 ing methods.

Q. So that in order that you would derive all the revenue that you thought you were entitled to in these mines, it was necessary for you to be exercising constant supervision over the mines?

A. We think so. It is customary I think.

Q. You did it?

A. We did, we carried on this inspection work.

Q. You maintained an office at Hibbing?

A. No, we had no office at Hibbing.

Q. Why is there an item of office rent?

A. It is for the office at Hibbing in proportion to the various properties that are inspected.

Q. You have got it charged as an item of expense.

A. The Meriden Iron Company makes up the bills, and it is itemized in the various expenses of the office, rent, superintendence, etc.

Q. In other words, the Meriden Iron Company maintains an office there?

A. Yes, sir, and the expense is distributed over a good many outside interests and other companies.

Q. And you pay your proportion? A. Yes, sir.

Mr. Van Derlip: These items with reference to the Hibbing office are not rent at all, it is Hibbing office expenses.

Witness: It is not charged as rent, it has not been so testified.

Q. There was a charge made against the company on account of occupancy of the building in which the Meriden Iron Company did business.

A. That is my understanding of it. I don't see
132 any items here for rent.

Q. I understood you to say that in the itemized monthly disbursements you included such an item.

A. I think that must be a mistake, because I don't find it in these statements.

The Court: It was office expenses.

Q. At Hibbing. A. Yes, sir, at Hibbing.

Mr. Van Derlip: I will put Mr. Warren on the stand, and he will explain fully about that.

Q. Items are charged against the Monroe mine, I suppose they are the same class of charges?

A. They are of the same general character.

Q. Of the same nature, yes, sir.

Redirect Examination

By Mr. Van Derlip:

Q. With reference to this testimony which you have been giving relating to general expense items of these three companies, the items which you have detailed here from month to month making up these charges, were read by you from the original bills rendered to you by the Meriden Iron Company for that work. A. They were.

Q. It was a memorandum which you had before you with respect to each month?

A. Bills rendered by the Meriden Iron Company to the Kearsage and Sargent Companies.

Q. You said that the Meriden Iron Company rendered each month to these companies a bill for all services per-
133 formed during the preceding month, whether it is greater or smaller, for the month.

A. That is correct.

Q. Counsel asked you yesterday in relation particularly to the Longyear mine so called, as to whether the income or the receipts on the lease of that mine represented the royalty upon ore removed and shipped, or whether they were advance royalties. You testified that they were advance royalties.

A. Yes, sir.

Q. What are the operations on the Longyear mine, what is the nature of the property as to the manner in which the lessee is endeavoring to mine the ore?

A. The Longyear mine is a stripping mine, so called.

Q. What do you mean by a stripping mine?

A. Where the surface is not too great in depth to warrant the expense of removing it by steam shovels, so as to expose the ore underneath; enabling the operator, after such removal of the overburden and the laying of a railroad track into the mine, to mine the ore with a steam shovel.

Q. From the ore exposed in the mine? A. Yes, sir.

Q. That is a stripping proposition?

A. Yes, sir, a stripping and steam shovel proposition.

Q. Was that Longyear mine of that character?

A. Yes, sir.

Q. During these years 1909, 1910 and 1911 in which these royalties have been paid, has the lessee been conducting that work?

A. The lessee has been conducting stripping operations. That is, removing this overburden, and getting ready to
134 mine, so that the ore can be mined out.

Q. In the manner in which you testified? A. Yes, sir.

Q. Is that an operation of some magnitude and duration?

A. It is of considerable magnitude. I don't remember the amount involved, but it will be a large stripping mine.

Q. But during these three years the lessee has been engaged in that stripping operation, so as to enable it to get this ore?

A. I think so. I am not entirely clear as to when this stripping operation commenced, but they have been carrying it on for some years past.

Q. In connection with that you testified that the minimum royalty or advance payment for each year amounted to $18,750. Did the company receive the full amount, or was 3% deducted from that by Mr. Longyear.

A. I think 3% was paid directly to Mr. Longyear.

Q. The $18,750 was the total advance royalty?

A. Yes, sir.

Q. Regarding the Alexander mine, it appears that the lease upon that property existing at the time these lands were conveyed to the plaintiffs was surrendered, I believe in 1908, and subsequently a lease was made in 1910 to the Oliver Mining Company. Will you please explain the nature of that property at the time of the surrender, and the reason for making the lease?

A. The original lease was made to the Republic Iron and Steel Company. They mined out what they claimed was all of the ore in the mine, and surrendered the lease. The
135 Platt Iron Company held a lease of the Forest Mine, which is in the same ore body, and lies contiguous to the Alexander mine on the east. The Platt Iron Mine Company desired to have a lease of the Alexander mine, and thought they could scram out some ore.

Q. What do you mean by scram out?

A. Scramming out a mine is where the mine has been pretty well exhausted and a concern comes along and gets out all that is left. It is usually done by very small operators, and sometimes by the miners themselves. They could do this, because they were operating the Forest mine and had their plant there. There was considerable water in both the Alexander and the Forest mine, and they had their pumps there, and they could keep the water out until they got what little ore there was in the Alexander. I wish to correct my testimony of yesterday that the Platt mine did not mine the ore; I think they did. It was a cash lease of $1200, and there was something like 1600 tons mined out by the Platt Company. That is all there was to it. Then they allowed the mine to fill up.

Q. Then this lease to the Platt Company was for the purpose of scramming out the ore?

A. Yes, what was left.

Q. It was to get the ore that was left?

A. Yes, it was scrammed out. The ore was lying just in small pockets, and the other company did not consider it worth taking out.

Q. If such a lease had not been made at that time, under those conditions, would not that $1200 and the ore have been wasted and lost to the plaintiffs?

136 A. Absolutely. We had no means of getting it out. We were not organized to get it out. The mine filled up immediately after the pumps were stopped in the Forest mine, and the pits filled up with water. The water was high in the pit and it was used as a reservoir.

Q. Something was asked you on cross-examination concerning the Monroe mine, and the advance royalties; what was the situation of that mine? A. In [waht] way?

Q. As to whether ore was taken out or not during those years.

A. There was; there was a very little taken out. There seems to have been only a very small amount of ore taken out of the mine.

Q. I don't refer to the ore that was shipped; I am asking you whether ore was mined and removed without being shipped. In other words whether it has been stock piled by the pit.

A. They have been mining ore for several years from the Monroe mine; they had made quite a stock pile.

Q. What do you mean by a stock pile?

A. A stock pile is where the ore is mined out underground and piled up on the surface of the land contiguous to the shaft. That ore is then in the stock pile, and, from time to time, as they desire to ship it, they put in steam shovels and load the ore into cars and then it is shipped.

The Court: When are the royalties paid in such a case?

Witness: Not until the ore is shipped. Not until it is removed from the premises. We would remove the ore to
137 wash it. The royalties are not due until the ore is removed.

Q. That washing provision does not apply to any of the leases referred to here?

A. Not at all. There is no washing property.

Q. What is the fact as to whether the Monroe mine was piling ore?

A. They have been operating during 1909 and 1910 in stock piling.

Q. What is the fact with respect to the application of this advance royalty towards the payment for ore in stock pile?

A. These advance royalty payments were made to us, and in future years ore can be [be] mined and shipped, and the credit which we give to our lessees makes it so that these payments can be used and applied in payment for that ore which is in excess of the annual minimum royalty payments for that year.

Q. In other words, in these cases, the royalty payments are precisely what the name implies, that is, they are payments in advance for ore? The lessee has a credit therefor when the ore is mined and shipped, and when so paid for, it does not have to be paid for the second time?

A. That is true. That statement is correct.

Q. I want to speak about the agency of E. J. Longyear, or, as you have said, the E. J. Longyear Company, for the sale of certain of these platted lots. Those plats, it already appears in evidence were made by the individual owners of that property before they were conveyed to the plaintiff corporations. You were, were you not, at the time these plats were made, one of those individual owners? A. I was.

138 Q. You are familiar with the facts surrounding the making of these plats? A. I am, yes.

Q. Can you state when the arrangement was made with E. J. Longyear with respect to his agency for the sale of these lots, do you know when that arrangement was made?

A. The arrangement was made, Mr. Longyear would keep track of the development of the Missabi range, and had full opportunity for observations of that kind. If he saw a good location for a town site or addition to a town site, he would come to us or he would come to other people and arrange to plat that ground; that is, do the engineering work and look after it, in consideration of his having the exclusive sale and disposition of the land, on a commission basis.

Q. Is it or is it not a fact that with respect to these platted additions of any one of the plaintiff corporations, Mr. Longyear was instrumental in causing the platting and did the platting himself with the exclusive agency for the sale of the lots contained therein? A. He was in each case.

Q. Were those arrangements made in every case prior to the transfer of the properties to the plaintiff corporations?

A. Yes.

Mr. Houpt: We object to this, as being contrary to the minutes of the board of directors put into this record.

The Court: I think there was only one plat, the Pearce addition, made after 1899. I will overrule the objection.

Q. In respect to the Pearce Addition to which reference was made and as to which you were cross-examined this

139 morning, in order that there may be no misunderstanding and no ambiguity in the record, will you state the circumstances with respect to that?

A. The Pearce 40 is the 40 acres on which the Pearce mine is located. The ore was about exhausted in the Pearce mine, and it was intended to plat that 40 into town lots. Some exploration work was done, some test pitting, to determine whether there was a little edge of the Clark mine extending over on to this 40. The work was done and nothing was found, and so steps were taken by the E. J. Longyear Company to plat the 40. A survey was made, I think, but the

village of Chisholm, the village council, refused to accept the plat, as there had been some addition platted on the north. There was some political influence brought to bear to prevent the acceptance of the plat, and the matter was dropped.

Q. The land was never platted?

A. No, sir, it was never platted.

Q. Is it still owned by the plaintiffs?

A. No, sir, it was transferred to the Meriden Iron Company.

Q. Counsel has had you read one or two portions from the records of these corporations relating to a certain street railway company. I wish you would explain to the court about that street railway company.

A. There wa. a street railway company organized to establish a line along the range, and they wanted to cross over some lands that we owned to get a right of way. We appointed a committee to consult with them to see where their line was going to run, and whether it was where we wanted it.

140 Q. What was the result of that?

A. I think we gave them the right of way over two or three pieces [pieces].

Q. That's all there is about the street railway?

A. That's all.

Q. That is, you gave them an easement for a right of way?

A. Yes, sir, that is our custom.

Q. You spoke yesterday, and you have again this morning, about the custom of the plaintiffs to declare dividends, so called, of the receipts of the corporations from time to time. As I recall it, you made some statement to the court with regard to dividends; I am not sure whether you have testified with regard to them so that they are in the record. Explain why the term dividends was used, and what as a matter of fact it means.

Mr. Houpt: I believe the witness has testified upon that point.

The Court: I dont' think he has testified as to what the word means.

A. Well, the word was used because it is customarily used as a term to designate the paying out of the money that has been received from the sale and disposition of the assets of the company.

Q. As a matter of fact, the dividends you have referred to in the record are no other than the distribution of the proceeds of sales the property and ore?

A. That was the only source of revenue of these corporations, the selling and disposition of its property, the declara-

tion of dividends of the proceeds as fast as we received
141 them, keeping a very small balance from month to month, or from quarter to quarter to pay our running expenses.

Q. If one be the owner of ore in place on the Missabi Range, what is the means of disposition of that, how is ore sold on the Missabi Range?

A. It is sold under a so called lease.

Objected to.

Objection overruled.

Witness: The customary way is to sell the ore by lease, such as these leases that we have here, paying a royalty rate, a fixed royalty, not on a sliding scale, that is not used on the Missabi Range. But a fixed royalty rate, based on so many tons of ore being paid for to you each year, whether the ore is mined or not. So there is an assured amount paid each year.

Q. To prevent the lessee from tying up the property of the lessor is it?

A. Yes, sir; otherwise it might be tied up a good many years without any returns.

Q. Is there any other practicable way of disposing of the ore by the owner of ore on the Missabi Range, except on a mining lease?

Mr. Houpt: That is objected to as immaterial and as calling for the conclusion of the witness, and for the reason that the transaction is fixed in these cases by the leases.

The Court overrules the objection, and counsel for defendant excepts to the ruling.

A. There have been cases where the ore has been sold outright; but the sale price would have to be so reduced,
142 that it is a very rare exception where property is disposed of ore is sold in a lump sum.

The Court: Do you mean the land or the ore?

Witness: The land. Sometimes the ore is sold, but it is sold in a lump payment. But that is very unusual. I don't know of more than one or two cases in my experience.

Q. In the history of the Missabi Range?

A. Yes, sir.

Q. Then as I understand you, such a sale is made only by making a great sacrifice of the property.

A. Yes, sir. The Oliver Iron mine prefers to pay a higher royalty, and makes a considerable higher royalty rate for ore under this leasing plan with payments each year, rather than purchase the fechold at a comparatively low figure.

Q. Rather than to pay out a very large sum to begin with?

A. It enables them to make payments as they market their product.

Q. What you have stated has been true with respect to the mode of disposing of the ore from a time previous to the organization of these plaintiff corporations?

A. That is the only method we have employed. It is the universal custom.

Q. You wanted to correct your testimony yesterday in respect to these licenses that have been given for occupancy of the surface of the land in Hibbing and one or two places, in relation to their renewal each year.

A. I stated that they were renewed each year and new licenses made or issued. I understand from Mr. Warren who has been looking after these things, that they were renewed automatically: that is, we give notice of their termination and they were renewed automatically from year to year.

143

Q. Let me call your attention to the lease of certain property in the village of Hibbing for which your rental receipts were approximately something like $240 a year. Will you describe the situation of that property, and the reason for [giveing] a license.

A. Pillsbury Addition to Hibbing is partially underlaid with ore. We owned the surface, and we owned the ore. That land was platted, and a portion of the lots was reserved for the uses and purposes of mining out the ore, so that on the surface they can sink a shaft etc. These lots have been reserved. In the village of Hibbing land is very scarce. The whole town is surrounded by open pits that have been made until they are all up against the town property on three sides. The result is that there is a great pressure to obtain business sites suitable for warehouses, and trackage for lumber yards and so forth. We have made it a rule, where we didn't need this land, to give licenses on it at what we considered a nominal valuation. That is, ordinarily we have based our valuation at from 50 to 75% less than what the lots are worth. In fact, we could sell the lots for a large sum of money. This has been done to aid the people of Hibbing. We have issued licenses to the school district for half a block on which there is a large school building. We receive no rental for that. They pay the taxes. We have issued some licenses for park purposes for which we receive nothing. Through the town there is a railroad, and we have issued licenses.

144

Q. Do you receive any rental for that?

A. No, sir. We have issued licenses on 50 or 60 acres which lie south of the village limits of Hibbing that we receive nothing for. We found it was public policy to permit this use. We

have not issued these licenses for the purpose of receiving revenue. We could get a good deal more than that if we desired.

Q. So that these sums that you are receiving as rentals are much below the real value of the rentals?

A. Yes, sir. There is another thing. Squatters will come to you for land to build shacks on, and if you have a licence out they will look after these squatters.

Q. Now in order to make it perfectly clear on the record with respect to these dividends, I desire to call your attention to a meeting of the directors of the Sutton Land Company on April 30th, 1909, appearing on page 63, and ask you to read the paragraph appearing on that page relating to dividends.

A. "The treasurer then presented his report in detail for the months of February, March and April, showing total receipts including balance on hand January 30, 1909 of $7,730, disbursements of $528.30, leaving in the hands of the treasurer $7,201.70. Mr. R. M. Bennett moved that a dividend of $2.75 aggregating $5940 be declared payable immediately. The motion was duly carried, leaving in the hands of the treasurer $1,261.70".

145 Q. Is the form which you have just read the form which is used regularly by the Sutton and by the other plaintiff corporations in declaring these so called dividends?

A. It is, I think, without exception.

Q. In each case the treasurer reports receipts for the preceding period, whether it be a month or a quarter, and thereupon the dividend resolution follows: is that right?

A. Yes, that is correct.

Q. The receipts disclosed in these reports of the treasurer at the meetings represent what?

A. They represent moneys that have ben paid into the treasury of the company from the liquidation of its assets.

Q. Anything else? A. Nothing else.

Mr. Van Derlip: I am going to offer in evidence one of these leases, so that the record will show what the form of the leases is, that is, as to its general terms.

Q. With the exception of the Van Buren Iron Mining Company lease, will you state whether or not all the other leases that have been referred to in these cases follow a single general form. A. They are all in substantially the same form.

Q. The differences between the leases being in the description of the parties and the property, and the amount of royalty to be paid for the ore mined and removed, to a very large extent? A. Yes, there may be some minor differences.

Q. But, [isn-t] it true, speaking generally, that the
146 leases all follow a specified form that is used on the Missabi Range?

[Q.] Yes, sir, the specified form that is used on the Missabi Range, they were used right along.

Mr. Van Derlip: I will ask to have marked as Exhibit 15 an indenture or lease dated March 1, 1912, between Frank H. Carleton and others being the then owners of the premises, and John B. Adams as lessee, and I offer it in evidence.

The Court: It is admitted.

Q. I show you Exhibit 15, and ask you if that shows the general form of the leases to which you have referred in your testimony.

A. It is. It is one of our forms of lease.

Q. And the terms and conditions of that lease with respect to the rights and obligations of the lessors and lessee, are the same terms and conditions as attach to these parties under these leases, with the possible exception of the Van Buren lease?

A. That is correct.

Mr. Van Derlip also produces and offers in evidence another lease, between Sargent Land Company, as lessor, and Van Buren Mining Co., as lessee, which is marked Exhibit 16 hereof and is received without objection.

Mr. Van Derlip: For the fullest information, I desire to offer in evidence a copy of the by-laws of the Sargent Land Company.

The same is marked Exhibit 17 hereof and received without objection.

147 Q. I will ask the witness whether the by-laws in each of the plaintiff corporations are identical in form.

A. The by-laws of the three plaintiff companies are identical in form.

Q. Then this copy or the by-laws of the Sargent Land Company, with the exception of the name, is precisely the same as the by-laws of the Sutton Land Company, and of the Kearsage Land Company. A. It is.

Q. I believe that is all, unless there is any explanation which you desire to make, or something to which you desire to call our attention.

A. Mr. Warren will be on the stand?

Q. Yes. A. Then there is nothing.

148 O. B. WARREN, a witness produced and sworn on behalf of the plaintiffs, testifies as follows:

Examination-in-Chief

By Mr. Van Derlip:

Q. Where do you reside? A. Hibbing.

Q. How long have you lived there? A. Seventeen years.

Q. Are you connected with the Meriden Iron Company?

A. I am.

Q. In what capacity? A. Manager.

Q. How long have you been manager of that company?

A. Since it was formed. At first my title was superintendent of mines, but it has been changed to manager.

Q. What is your profession? A. Mining Engineer.

Q. That is the same Meriden Iron Company that has been referred to by the witnesses for the plaintiffs in this case?

A. It is.

Q. And you are the same O. B. Warren who has been referred to in the testimony of these witnesses? A. Yes, sir.

Q. You have heard the testimony in this case? A. Yes, sir.

Q. Does the Meriden Iron Company make and file with the Collector of Internal Revenue for the district of Minnesota, a report of its annual income under the Corporation Tax in each year? A. It does.

Q. Has it done so for each year since the act has been in effect? A. Yes, sir.

Q. Has it paid the taxes assessed against it under that
149 act? A. Yes, sir.

Q. Does the income so reported from year to year of the Meriden Iron Company include the receipts by it from the Sargent, Sutton and Kearsage Land Companies during the respective years covered by the report.

Objected to.

Objection sustained.

Plaintiffs except.

Q. What is the business of the Meriden Iron Company?

A. Mining ore, the inspection of ore properties, engineering, inspection of mineral properties anywhere of iron ore propertes.

Q. Iron ore properties? A. Yes, sir.

Q, Are the operations of the company confined to any one locality? A. No, sir.

Q. What range of territory do you cover in your operations?

A. The Messaba Range, the Vermillion Range, the Marquette Range, Crystal Falls, Menomonie.

Q. The Messaba and Vermillion ranges are in Minnesota?
A. Yes, sir.
[—] The Marquette and the Crystal Falls are in Michigan?
A. Yes.
Q. The Meriden Iron Company is now operating at Menomonie in Wisconsin? A. Yes, sir.
Q. Did you do business there?
A. I have personally, but not for the Meriden Iron Company.
Q. Have they at any time done business on the Cascade Iron Range, in that part of the Menomonie Range?
A. Yes, sir.
150 [—] Are you familiar with the bills that are charged from month to month by the Meriden Iron Company and sent out to its patrons, including the plaintiffs?
A. I am.
Q. In your operations on these various ranges do you do business for other companies than the plaintiff companies?
A. Yes, sir.
Q. Or for other individuals? A. Yes, sir.
Q. In the bills which you have rendered to the plaintiff companies, from which Mr. Bennett testified this morning, what does the item "[Superint-ndence], O. B. Warren, "mean?
A. It covers actual salary, the Meriden Company's profit, and such costs as go to the superintendence, aside from office expenses and travelling expenses.
Q. Attention was directed to the item of "Hibbing office expenses" in these bills included in the amounts paid by the plaintiff corporations from month to month; please explain that item.
A. The item of Hibbing office expenses covered the general clerical work, general stenographers' work, general telephone, not telegraph, but telephone, janitor's services, and all such minor expenses in the office, including the Meriden Company's profit.
Q. Do you render bills of the same character, itemized in that same general way, to all of your patrons? A. Yes, sir.
Q. Will you explain to the court the purpose of making your bills in that rather unusual way.
A. The purpose is to save clerical work, and keep a permanent systematical form. I might add in addition, that that being the general form, we furnish itemized statements to
151 all who care to have them.
Q. All the items making up these different amounts in the bills? A. Yes, sir.

Q. Upon the face of it it might appear that you were rendering bills for the exact cost of all these items; what is the fact as to that?

A. The fact is that we have a regular basis of charges. We include the actual cost, the Meriden Company's profit is in that.

Q. Is it or is it not true that in each of these items as shown from the bills rendered by you to the plaintiffs and other parties, the actual amount in each of these items represents the actual cost with the profit referred to added? A. Yes, sir.

Q. Then, as I understand your testimony, the fact is that the amounts paid by the plaintiff corporations to the Meriden Iron Company, from month to month, represent not merely the exact cost of the work, but represent the exact cost of the work plus your percentage of profit, whatever that may be, as agreed upon. A. Yes, sir.

Q. Are these bills as presented by the Meriden Company from month to month paid by the plaintiff corporations?

A. They are.

Q. What becomes of the funds so received?

[Q.] They are turned into the Meriden Iron Company.

152 Q. Beyond the fact of a community of interest, so to speak, between the stockholders of the plaintiff corporation and the stockholders of the Meriden Iron Company, is there any difference between the connection of the Meriden Iron Company with the plaintiffs and with any other of its patrons?

A. Not any, with what we call regular patrons. Not any difference with the Kearsage Land Company and the other plaintiff corporations and the corporations that we are retained by, and whom we represent regularly; but we do have some occasional patrons whom we charge more for our services; perhaps one or two days' work rendered in the course of two or three years. Of course we have to charge more to these special patrons.

Q. Is the nature of the business of the Meriden Company such that the greater part of its services are rendered regularly for its patrons, in respect to properties in which they are respectively interested? A. Yes, sir.

Q. As regards these patrons, as I understand you, the profit you speak of is not so large as from these occasional patrons who ask you to do an isolated job taking a day or two? Do I understand you correctly?

A. That is the correct understanding.

Q. When an item is entered against these plaintiffs of a charge for "superintendence by O. B. Warren," does that not

indicate that the service, so far as the plaintiff corporations are concerned, is the service of the Meriden Iron Company?

A. It does.

153 Q. The use of the words, O. B. Warren, or O. B. Warren Superintendent for a charge of superintendence, is intended merely to indicate that you have given it personal attention?

A. It covers my personal attention. We often render bills in which there is no charge for superintendence, as in inspection of taxes, where the charge would be for special clerical work.

Q. From whom do you receive your compensation?

A. From the Meriden Iron Company.

Q. Are you in the employ, in any capacity, of any one of the plaintiff corporations? A. No, sir.

No cross-examination.

R. M. Bennett, recalled on behalf of the plaintiffs, testifies as follows:

Examined by Mr. Van Derlip:

Q. I want to ask you [wirh] reference to the resolution which Mr. Houpt asked you to read, appearing in the minutes of the directors' meeting of May 27, 1909, which is found on pages 61 and 62. That resolution refers generally in its recital to an existing contract between the Kearsage Land Company and the Oliver Mining Company relative to the

154 mode of operation by the Oliver Mining Company in the Glen mine so called. In the course of these recitals, or in the second resolution, I find this language: "Resolved further, that the Kearsage Land Company expresses its unqualified endorsement of the competent and thorough manner in which Mr. O. B. Warren has conducted his supervision of the Glen Mine and regrets that the Oliver Mining Company has felt that there has been any occasion for any criticism of his methods. Resolved further that this resolution be spread upon the minutes of this meeting, and that a copy thereof be mailed by the secretary to the Oliver Mining Company and to Mr. O. B. Warren."

I also find in the third recital of the preamble to these resolutions, this: "Whereas the Kearsage Land Company has employed Mr. O. B. Warrem as its general superintendent, and has instructed him to carefully inspect the mining operations being carried on by the Oliver Mining Company in the Glen

mine, and to require the lessee to mine all ore assaying 45% or over in metallic iron, wherever by the mining operation of ore of that grade, if not mined when the ore containing 57% and upwards of metallic iron is mined, will be left 'unreasonably inconvenient for the future mining thereof, etc." And then further along, "Whereas pursuant to his instructions Mr. Warren has required the Oliver Mining Company to mine and ship, and to conserve for the future benefit of itself, or of the fee owner, this overlying stratum of low grade ore"
155 which is the ore referred to previously. Now I direct your attention to these, to inquire why Mr. Warren's name was used in these resolutions rather than the name of the Meriden Iron Company.

Mr. Houpt: That is objected to, as contradictory of the record made by the corporation, and as tending to impeach that record.

The Court overrules the objection, and counsel for the defendant excepts to the ruling.

A. At the time that this disagreement arose we had some correspondence, and finally we had a meeting, at which Mr. Snyder, Mr. Warren and myself were present and the officers of the Oliver Mining Company. At that meeting this matter was taken up and discussed. The officials of the Oliver Mining Company, and Mr. Olcott especially, rather discredited Mr. Warren's methods, claiming that he was unfair in his attitude. We at that meeting agreed upon this settlement, as stated in these resolutions; that is, to allow them to cave the ore in this particular instance, and we drew up resolutions. It was decided that in order to get on the record, to back up Mr. Warren, that we would pass such resolutions as these, in order to make the matter stronger. That is, instead of using the name of the Meriden Iron Company which would be impersonal, we used Mr. Warren's name, in order to back him up in this attitude which he had taken in the inspec-
156 of that property. That was the idea at that time. Mr. Warren was employed by the Meriden Iron Company at that time just as he always had been.

Mr. Van Derlip: I do not know whether it is necessary that we should offer in evidence the Articles of Incorporation of these plaintiff companies. They are made a part of the complaint.

Mr. Houpt: They are admitted to be in the form shown by the complaint.

Q. In speaking of the lease made by the Sargent Land Company in the year 1910 to the Platt Iron Company, which is known as the Alexander mine, you stated that the ore was left to be scrammed out of the mine, and that it was not taken out by the Sargent Company because it was not organized so it could do it. Will you please state what you meant by the expression that the company "was not organized so that it could do it"?

A. The articles of incorporation of the Sargent Land Company had been amended in 1909, which would not permit us to engage in mining [oparations]. The only way to save the ore that was there was to make a lease of it.

Q. That was the signification [whuch] you intended with reference to the term "organized"?

A. That is what I meant, that we were not permitted to do the business.

Q. You did not refer to the fact that the Sargent Company had no facilities by way of employment of engineers?

A. No.

Q. One other question. In 1909, 1910 and1911 it appears that the Sutton Land Company sold some hardwood timber in various small amounts. What was the particular
157 circumstance which led to the sale of that timber?

A. Fires had got in at the time of the Chisholm fire, at the time the town of Chisholm burned. Fires had burned over the range for a succession of years, and fire had burned over this particular timber. We had the timber examined occasionally for the purpose of disposing of it, to see what there was of it. We found that this timber had been burned in certain localities. It was so that if we had not disposed of it it would have [eebn] been worthless in a year or two.

Q. That is the timber that you testified was sold?

A. Yes, sir, the timber was sold under those circumstances.

Cross-Examination

By Mr. Houpt:

Q. What was the object of amending the articles of incorporation?

Mr. Van Derlip: That is objected to, because the record shows for itself. It recites particularly the purposes for which the alteration was made.

The Court: I will sustain the objection.

Q. Was the object of amending the articles of incorporation so as to escape liability under the corporation tax?

Mr. Van Derlip: That is objected to as immaterial and incompetent.

The Court sustains the objection.

Q. [It] selling that timber after it being burned, you proceeded just as any timber land owner would have done, did you not?

158 A. We found that fires had run through this timber, and if it remained for any length of time without being cut, it wouldn't be worth anything.

Q. Any land owner would have [dome] the same thing, either would have sold the timber or cut it himself?

A. I presume so.

Q. Is it not a rule among timber people or owners of timber, that when fires have been through it, in order to save it, they either sell it or cut it themselves?

A. Yes, sir, they dispose of it or cut it.

Q. You were proceeding on sound business principles when you did that.

A. We proceeded upon the theory that if it remained there it wouldn't be worth anything.

Q. Then it was sound business principles that actuated your conduct, was it not?

The Court: I will rule that out.

Mr. Van Derlip: With respect to the amendment to the articles of incorporation, while I think the resolution itself was offered, I will offer specifically in evidence the record of the meeting of the Sargent Land Company on December 22, 1909, as found on pages 170 and 171 of the record, and I will read that resolution.

Mr. Houpt: I object to the reading of the resolution with the view of showing what the purpose of that amendment was, because it appears from the testimony of Mr. Bennett that the minutes of the meeting of the board of directors did not

159 mean what they said upon their face, and therefore are not reliable.

The Court overrules the objection, and counsel for defendant excepts to the ruling.

Mr. Van Derlip then reads as follows:

"Upon motion of Mr. Van Derlip seconded by Mr. John Pillsbury, the following preambles and resolutions were adopted by the unanimous vote of all the [shoreholders] and of all the shares of stock present and represented:

'Whereas the Sargent Land Company is a corporation which was created with the object of bringing into one ownership the numerous undivided fractional interests in certain lands in the State of Minnesota held by the various persons (having widely separated domiciles) now constituting its stockholders, many of whom were minors and were unable to execute valid instruments relating to such lands, and whereas the corporation has acquired such undivided interests and now holds the record title to said lands, and is enabled to manage and control the same for the benefit of its stockholders—former owners thereof—conveniently and [eco-mically]; and whereas it is desirable that the articles of incorporation of said Land Company should express with complete accuracy the purpose and scope of its organization, and the nature of its title to and ownership of said lands; Resolved"—

Mr. Van Derlip: Then follows the resolution which has been already produced in evidence. I now offer in evidence from the record book of the Kearsage Land Company that portion
160 of the record of the meeting of the stockholders on December 22, 1909, found upon pages 71 and 72 of that record book, in precisely the same language as I have read. From the record book of the Sutton Land Company I offer in evidence that portion of the record of the meeting of [th-] stockholders of that corporation on December 22, 1909, found upon pages 68 and 69, in precisely the same language as that which I have read from the record of the Sargent Land Company.

The Exhibits heretofore produced by plaintiffs, being numbered 1 to 17 inclusive are received in evidence without objection, save where the same have been specifically objected to, as appears in the record herein.

Plaintiffs rest.

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161 (Testimony for Defendant.)

GEORGE W. SCOULER, a witness produced and sworn on the part of the defendant, testifies as follows:

Examination-in-Chief

By Mr. Houpt:

Q. Where do you live? A. I live in Pennsylvania.
Q. You are in the government service?
A. I am an Internal Revenue agent.

Q. Did you have anything to do with making up the accounts of these three corporations, for the purpose of assessing a tax against them?

A. An Abstract from the returns filed by these three companies was furnished me, with instructions to examine the books and see that a return was prepared accordingly.
In the case of the Sargent company the Kearsage company and the Sutton company I visited the office in Minneapolis last December.

Q. Did you receive your instructions from the Commissioner of Internal Revenue?

A. He sends on an abstract showing the figures which were furnished by the companies.

Q. You may state in what manner you prepared the account of the Sargent company for assessment and tax for the year 1909.

A. I examined the books of the company, and found 1910, based upon that examination, the gross income was $395,732.90. Then they were entitled to deductions for the necessary maintenance of the business $5,458.83, and for taxes paid
162 $540.38, making a total of $5,999.21, leaving as net income $389,733.69, then making the specific deduction of $5,000, that left as taxable income $384,733.69. I prepared a regular form of property return, and forwarded that. That was the basis of it, and these were the figures on which the assessment was made.

Q. Was there any other deduction made on account of 3%?

A. I can give you the detail of these figures if you want them.

Q. Was that deduction made?

A. I found the gross income so much less the percentage, and the land sales.

The Court: This 3% commission of Mr. Longyear's was taken out?

Witness: Yes, sir, it was taken out.

Q. Did the land sales you spoke of form a part of the gross income? A. Yes.

The Court: Was that true of all the years?

Witness: I might say that the figures furnished—

The Court: I am asking you whether or not the proceeds [off] the land sales formed a part of the gross income.

Q. Was that true also of the stumpage?

A. Yes, sir; the gross income consisted of advance royalties advance sales, specific sales of other lands, interest, discount and rents. Then in 1911 I found gross income $500,741.64, deductions for expenses and taxes amounted to $4,121.47, leaving $496,620.17, and deducting $5,000, left for taxable in-
163 come $491,620.17. I also made a return for the year 1909 in the same manner. That year had been overlooked, and I called the attention of the company to it, that they should file a return for the year 1909. The figures I found from the books for 1909 showed gross income $279,510.22, with deductions for expenses $7,661.67, taxes $488.51, total $8,150.18, making net income $271,360.04, deducting $5,000 it left as taxable income $266,360.04. This is for the three years.

Q. In each instance the 3% commission of Mr. Longyear was deducted. A. Yes, sir.

Q. Were any penalties added to these figures?

A. I believe that 50% was added to these figures for failure to make a return as required by law.

Q. Now as to the Kearsage.

A. 1909, gross income 123,102.42 [-xpenses] $12,729.58. Taxes $61.97, total deduction $12,791.55, net income $110,310.87, deducting $5,000 left as taxable income $105,310.87. For the year 1910 I reported gross income $131,592.48, expenses $8,068.79, taxes $65.86, total deductions $8,134.65; net income $123,457.83, deducting $5,000, leaves as taxable income $118,457.83. For the year 1911, gross income $146,607.45, expenses $7,241.33, taxes $69.25, [totoal] deduction $7,310.58, net income $139,296.87, specific deduction $5,000, taxable income $134,296.87.

Q. Now for the Sutton Land Company.

A. For the year 1909 gross income $25,740.00; Expenses
164 [$1508.8.;] Taxes $439.34. Total deductions $1,948.15. Net income $23,791.85. Specific deduction of $5,000. taxable income, $18,791.85. For the year 1910, Gross income $24,820, expenses $1829.07. Taxes $456.76. Total deductions $2,285.83; net income $22,534.17; [specicfic] deduction $5,000 leaves taxable income $17,534.17. For the year 1911 Gross income $24,750; expenses $1,736.93, Taxes paid $370.57 total deduction $2,107.50. Net income $22.642.50, specific deduction $5,000 taxable income $17,642.50. Those are the figures I took from the books, as shown by the lease account.

Q. The deductions you made in all these cases were 3% commission of Mr. Longyear. A. Yes, sir.

Q. Did you find upon the books of either of the plaintiff companies any claim for depreciation?

A. Nothing on the books at all.

Q. There was no depreciation charged on the books?

A. No, sir.

Cross-Examination

By Mr. Van Derlip:

Q. You are an expert accountant?

A. I believe so, yes, sir. It is rather a broad question, but in this particular line I claim to be an expert.

Q. I understood you to say that from your examination of the books you made out an account in proper form in connection with the figures which you have given us.

A. Yes.

165 Q. And you returned that to the Commissioner in Washington?

A. I prepared a corrected return which was filed with Mr. McGinnis the chief in charge, and he forwarded it to Washington.

Q. The corrected return [whi-h] you say you prepared, what became of that?

A. It was forwarded to the Commissioner with all the data, so he could pass upon the merits of the case.

Q. That return was accepted by the Commissioner in lien of the return made by the plaintiffs, and the tax was based upon the return made by you?

A. Yes, sir. You based your original return showing no income. They all showed a deficit, so there could be no taxable income.

Q. The difference between the return made by you and that made by the plaintiff companies was the item of depreciation for ore sold in mining the property.

A. Your income was offset by depreciation to that extent that it covered all the receipts, no matter from what source.

Q. But the depreciation from your examination of the books, was from ore sold under mining leases.

A. No, sir. There was nothing in the books at all. No claim was made other than the original return.

Q. From your examination of the books, and your examination of the returns as filed by the plaintiff corporations, were you able to determine what composed the item of depreciation, as it appeared in the return filed by the plaintiffs?

A. The only thing I could gather from that was from
166 conversations I had with Mr. Bennett and Mr. Snyder, which is part of the report as far as the claim goes.

Q. [Isn-t] it a fact that the amounts specified in the returns filed by the plaintiff companies coincide precisely with the amounts of the ore sold under these leases?

A. No. You included your lands and some of your interest. You included everything and showed a deficit.

Q. Did not the figures for ore sold and for lots sold agree with the aggregate amount of depreciation made in the returns filed by the plaintiffs?

A. What particular company would you like to have?

Q. Please answer my question.

A. In a general way, no. In 1910 the original return as filed by your company showed $131,592.93.

Q. What did your examination produce?

A. $131,592.48. That difference is in the taxes, I made them a little less. You claimed under your original return a depreciation of that precise amount. In making up the Glen mine royalty return and the Monroe Advance payments interest and discount were included for that particular year. I believe it was called interest and discount. It was interest received.

Q. There will be a deficit whether the depreciation amounts to more than the income or not. But, isn't it a fact, speaking broadly, that the difference between the account which you claim is correct, the account made up by you, and the
167 account filed by the companies for the same year, is in the amount claimed by the companies to be allowed for depreciation, consisting of the amounts received by them on account of ore sold, on account of lots sold, and in some cases on account of timber sold? A. In some cases that is possible.

Q. But speaking generally, the difference between your account and theirs was that they claimed for depreciation of the property, on account of sales of ores sales of lots and sales of timber.

A. The difference between the original and the other return is the claim for depreciation.

Q. If the company sold lots or sold acres the assets would be decreased in that amount in any year, would they not?

The Court: I think I will decide that myself. I do not think that it is a question for the witness to determine.

Q. Is it or is it not a fact that you in making up what you call the correct return for these companies, omitted all the items of depreciation, for the reason that under their system of bookkeeping they did not maintain a so-called depreciation account?

A. It is a fundamental principle that they will not accept any claim for depreciation unless it is evidenced by some reduced value of assets.

Q. That was the sole ground of objection to the depreciation items found in the returns made by the companies; it was the fact that their books did not have any depreciation account?

A. That is the practical question. It must be on the books first; afterwards it is decided on its merits.

168 Q. Is it or is it not the fact that your reason for the rejection of any allowance in the returns made by you for depreciation, was because there was no depreciation account carried on the books of the companies?

A. No, sir. I always look up this matter and try to keep it right. In this particular case it was taken up by the Department. The government had rejected the [—]. They [simoly] say you just make a return, hence it was out of my hands.

Q. If there had been a depreciation account kept in the books of these companies would you have looked into it?

A. I would have gone into the matter as fairly as possible, threshed it out, and put it up to the department,

Q. Would you have made in what you call your correct return, an allowance for depreciation?

A. Yes, sir, I would have made a return based upon my examination.

Q. Then on your account as corrected, returned by you to the Commissioner, you did not make an allowance for depreciation because there was no depreciation account on the books of the companies?

A. Primarily there was nothing on the books. The merits of the case had been taken away from me. It was a direct communication between me and the Commissioner. I am the agent of the Commissioner.

Q. The fact is, is it not, that you struck out any allowance in what you call the correct return, on account of depre-
169 ciation, because there was nothing shown on the books, and it was left to the Commissioner.

A. I can give you my report. It will cover the whole of that.

Q. Please answer yes or no.

A. I can't answer your question yes or no, because of the peculiar conditions. That particular claim had been taken up with the department. My figures are simply based upon the fact that there is no depreciation on them. The report goes to the Commissioner, and he considers the merits of the claim.

Q. You [kn-w] the Commissioner claimed that you had gone into this on its merits; but as far as that report was concerned, you intended that as a report of what the books showed?

A. My return threw the claim out because it was not evidenced. The case had been taken up by the higher authorities.

Q. Consequently, your report consisted of a summary of your examination of the books.

A. Yes, sir, it did. It was a book examination.

Q. Will you explain to me what the method of these plaintiff corporations was, under their bookkeeping system, of pro-

viding for the receipts from the sales of property, whether ore, lots or timber sales, as long as we had no depreciation account, what method did they pursue?

A. They had a profit and loss account; all the receipts were credited I think to profit and loss account, and debited; the charges against it were debited.

Q. It would be necessary in a bookkeeping system,
170 either to have a profit and loss account or a depreciation account, would it not?

A. Or have both.

Q. They could have both? A. Yes, sir.

Q. But it was necessary to have some account, in order to balance the receipts or dividends, would it not, to show the disposition on the books?

A. They have to have an account to show what becomes of the money of course.

Q. One way of doing that would be to charge to so called depreciation account?

A. Depreciation is either a reduction of the capital assets or a loss in their value, or it is a taking of the profits and setting them aside as a provision for depreciation. If you did that you wouldn't have any profits distributed, they couldn't be distributed as profits.

Q. My question was, it would be necessary in a proper bookkeeping system to have one account of profit and loss account, or a depreciation account into which they are charged.

A. You may have a profit and loss, or loss and gain account; but a depreciation account is separate and distinct, that has nothing to do with it.

Q. Depreciation varies of course according to the nature of the property. A. Yes, sir. If it be real property there might not have been any necessity for opening [for opening] a depreciation account. A certain amount of money would be set aside for the purpose of maintaining the property.

171 Testimony closed.

The Court: That is a question of law to be decided by the Court. But I do not consider that the not keeping of a depreciation account is at all material.

Testimony closed.

(Memorandum of the Court.)

The Court: These corporations are subject to the tax if their gross income, after making the necessary deductions, brings them within the law; but if the evidence in these cases shows that they have not received anything which can properly be called gross income, then they are not subject to the law, and the judgment will have to be for the plaintiffs.

172 (Defendant's Request for Findings and Declarations of Law, and Exceptions to Rulings thereon.)

At the conclusion of the testimony in these cases the defendant requested the Court to declare and hold the law of these cases to be as follows:

I.

That the royalties paid to and received by the plaintiffs under and pursuant to the several mining leases referred to in the evidence constitute and are gross income within the spirit and meaning of the Corporation Tax law approved August 5, 1909.

II.

That the Commissioner of Internal Revenue was authorized by said Act of Congress to assess against the plaintiffs the taxes mentioned in the complaints herein upon the royalties paid to the plaintiffs for the years 1909, 1910 and 1911.

III.

That the defendant is entitled to judgment for the taxes collected under and pursuant to the assessment made by the Commissioner of Internal Revenue, being the same taxes to recover which these actions were instituted.

Each of said requests was overruled and denied by the Court, to which ruling of the Court overruling and denying the several requests of the defendant, defendant severally excepted thereto, which exceptions were allowed by the Court.

CHARLES A. WILLARD,
Judge.

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173 (Opinion of the District Court.)

At the close of the evidence, Willard, J. delivered the following oral opinion:

In the case of Flint vs. Stone Tracy Company, 220 U. S. 107, the Court held that this is a tax upon the privilege of doing business in a corporate capacity. There are in that statement two elements: one, "doing business", and the other "in a corporate capacity". That these three companies the plaintiffs here are acting in a corporate capacity is unquestioned. It was said in this same case on page 162, that Congress was justified in imposing an excise tax upon corporations, on account of certain advantages which accrued from carrying on busi-
174 ness in that capacity. The court said on page 161;

"The thing taxed is not the mere dealing in merchandise, in which the actual transactions may be the same, whether conducted by individuals or corporations, but the tax is laid upon the privileges which exist in conducting business with the advantages which inhere in the corporate capacity of those taxed, and which are not enjoyed by private firms or individuals. These advantages are obvious, and have led to the formation of such companies in nearly all branches of trade. The continuity of the business, without interruption by death or dissolution, the transfer of property interests by the disposition of shares of stock, the advantages of business controlled and managed by corporate directors, the general absence of individual liability, these and other things inhere in the advantages of business thus conducted, which do not exist when the same business is conducted by private individuals or partnerships."

All of these advantages these corporations enjoy, and the evidence in the case shows that they enjoy them to a higher degree than happens in most corporations: The large number of owners of the property, the fact that some of them were minors and the fact that the property owned was property which could be leased most [advantageousl-] for more than 25 years, in which leases a guardian could not join, show almost a necessity that the owners of these properties should transact business in a corporate capacity. They indicate that these companies would, all other circumstances being equal, be under more obligation to pay this tax than others who did not secure so many advantages from the transaction of business in a corporate capacity. But this is immaterial, and I lay aside for the purpose of this case, all evidence relating to the complex character of the title and the number of owners, and look at the case in exactly the same way that I would look at it if Mr. Bennett, Mr. Longyear and Mr. Snyder being the sole
175 owners, had organized the companies.

The principal question on this branch of the case is, whether these corporations are engaged in business. The definition of that phrase in Flint vs. Stone Tracy Company has already been read by Mr. Van Derlip. The court said at page 171:

"It remains to consider whether these corporations are engaged in business. 'Business' is a very comprehensive term and embraces everything about which a person can be employed. Black's Law Dict. 158, citing People vs. Commissioners of Taxes, 23 N. Y. 242, 244. 'That which occupies the time, attention and labor of men for the purpose of a livelihood or profit.' Bouvier's Law Dictionary, Vol. 1, page 273."

It is said that this case is identical with the case of Zonne vs. Minneapolis Syndicate, 220 U. S. 187, but I see quite a marked distinction between the two cases. It is true that in this case valuable property has been leased for a number of years, and that the companies, so far as that property is concerned, received royalties. In this respect they are similar to the Zonne case. But in the Zonne case, so far as the report of that case shows, the owner of the land had nothing to do with the management of the business. It had no supervision over the renting of the building and had no interest in supervising it. Here the evidence shows directly the contrary. It shows that under the terms of the lease the owners of this property have the right to inspect the work in the mines as it proceeds. It not only shows that the companies have that right, but it shows that they in fact exercised it and are exercising it It shows hat they are doing that for their own advantage, for the purpose of seeing that all the ore which is valuable and which the lessees are bound to take out, is taken out. This appears through all the testimony. It appears in the testimony of Mr. Bennett, and it appears in the resolutions adopted to settle te differences between the Oliver Mining Company and

The Kearsage Land Company, with reference to the Glen
176 mine; showing in fact, that the lessors, so far from remaining idle and passive, and doing nothing but receiving the rent which was paid to them, exercised constant watch and care over the operations of the lessees. They did that, and they must have done it necessarily, I assume, because the testimony is that they considered it for their advantage and profit to do so. If that were all that the evidence showed, I should say that this case was radically distinguished from the Zonne case, also radically distinguished from the Nipissing case and from the Minehill case, because in no one of those cases did the lessor have anything whatever to do with the operation of the physical property. In all three of those cases the lessors simply received the money. They exercised no supervision over the management of the property, and had no right to do so, so far as the cases show.

But that is not all. The evidence shows that these three companies during each one of the three years were engaged in selling real estate, and so far as those sales are concerned, they were not small. The Sargent Land Company's sales amounted to $4,624 in 1909, to $6,629 in 1910, and in 1911 they amounted to $3,385. That was engaging in business, to my mind, it was selling real estate. They also did other things which have been referred to as being of such a light and trivial character as not to justify the court in holding that they con-

stituted a doing of business, such as the sale of stumpage from some of the property which had been burned over, leasing some properties at Hibbing, and taking leases from squatters in order to more easily evict them. It is true that those matters were trivial, but they indicate that the companies were constantly supervising and caring for this property. It was their business, and in fact it was necessarily their business, because there was no one else to do it. They had to take care of that part of their property which was not leased, some one had to take care of it, and they did take care of it. There was evidence that the Kearsarge Company in conducting the explorations in 1909 incurred an expense of $990 in test-pits.
177 I assume that that was for the purpose of exploring the property to ascertain what its value was. It was an exploration of the socalled Pearce 40 to ascertain whether or not there was any more ore there. Under the head of inspection, the Sargent Company in 1909 employed Longyear during explorations made by the Great Western Mining Company to take samples and classify them. I understand that the Great Western Mining Company was not engaged in mining operations, but it was simply exploring for itself, and the Sargent Company supposed that it would be for its own benefit to know something about what was going on. All these things indicate to my mind the doing of and engaging in business. It was doing the business of handling a large property, selling lots, and seeing that the lessees lived up to their contracts. If that is not engaging in business, I do not know what is. But it is said that it was not for any gain or profit. It is said that no company comes within the operation of this act unless it is organized for profit. I do not know that it is necessary to decide exactly what that means in this case, although my present opinion is that the words "organized for profit" are used to distinguish these corporations from charitable corporations; that any corporation organized by private persons for their own advantage and interest, and not for social, charitable or beneficent purposes, is organized for profit; and that a company organized as these companies were, to acquire title to an estate for the purpose of liquidating it and dividing the proceeds among the owners, is organized for profit, as that term is used in the act in question. And the persons who organized these companies evidently considered it so, because when the first articles were adopted they were drawn under the provisions of the Minnesota Statutes which related to companies organized for profit.

There was considerable evidence to show that the companies themselves did not engage in the business of selling lots, and did not themselves do the inspection, but that such work was done and the sales were made by other companies em-
178 ployed by them; that the Meriden Iron Company was employed to do the inspection, and that the E. J. Longyear Company was employed to sell the lots. The fact that they employed a company to do the selling on a commission, instead of having their treasurer or manager do it, does not relieve them from the charge of doing business. The same is true with regard to this inspection work. They might have employed Warren themselves to do this work, and if in so employing him they would be engaged in doing business, they certainly would be if they employed a company to do it. In fact, in the case of McCoach vs. Minehill & Schuylkill Haven R. R. Company, which was decided on April 7th, 1913, by the United States Supreme Court, the court said:

"From the facts as stated above it is entirely clear that the Minehill Company was not, during the years of 1909 and 1910, engaged at all in the business of maintaining or operating a railroad, which was the prime object of its incorporation. This business, by the lease of 1896, it had turned over to the Reading Company. If that lease had been made without authorization of law, it may be that for some purposes, and possibly for the present purpose, the lessee might be deemed in law the agent of the lessor; or at least the lessor held estopped to deny such agency."

I do not myself think that the amendment of the articles of incorporation makes any difference, so far as this case is concerned. The original articles authorized the company to engage in the business of buying and selling real estate. The amended article provides as follows:

"The general purpose of the corporation is to unite in one ownership the undivided fractional interests of its various stockholders in lands, tenements and hereditaments, and to own such property, and, for the convenience of its stockholders, to receive, and distribute among them, the proceeds of any disposition of such property at such times, in such amounts, and in such manner, as the board may determine."

It is true that that amendment specifically mentions
179 only receipts of the proceeds, but it authorizes the corporation to own property. The power to sell the property so that the proceeds can be received, is necessarily implied

by the article itself. The corporation owns the property; if it is to distribute the proceeds of a sale it must itself make the sale, for no one else can do it. This is the theory upon which the corporations have proceeded. Since the amendment the directors have taken care of the property, have sold some of it, and have done this in strict conformity with the amended article.

But this question, I think, has been decided by the case of Mitchell vs. Clark Iron Company, 220 U. S. 107. The bill alleged in that case in effect that the defendant Iron Company was the owner of the land described in the bill; that prior to the passage of the act in question it had leased the land; that it had done no business, except to watch over and care for said lands, and receive rents and royalties therefrom, and distribute the same among the stockholders, and such business as was necessary to defend the title. That was the allegation upon which the case was decided. The evidence in this case does not show it in any more favorable light for the plaintiffs. Upon that allegation the Supreme Court decided that the company was doing business within the terms of the act. I must therefore decide that these companies were so doing business.

Reported with the case of Flint v. Stone Tracy Company is the case of the Fifty Associates. On page 170 is said:

"They are operating under a charter to own real estate with power to build, improve, alter, pull down and rebuild, and to manage, exchange and dispose of the same."

That company was held to be doing business or engaged in business within the purpose of the act.

I have already referred to the case of McCoach vs. Minehill Railroad Company and the case of United States vs. Nipissing Mines Company. As I have said before, I think that they are not controlling authorities in this case, and I have come
180 to the conclusion that these companies were during all the times named engaged in business, so as to bring them within the operation of the act, and that it was their duty to make returns.

But the next question, and to my mind the important question, is whether or not the sums of money which were received by the companies during these years as royalties and on the sales of lots were gross income within the meaning of the act. It appears from the evidence that the Collector treated the

gross receipts of the companies as "gross income". The question of what income was, or what depreciation was, was not raised in the case of Mitchell vs. Clark Iron Company, and it was not raised in any of the cases decided at the time the case of Flint vs. Stone Tracy Company was decided. The only question there, as I understand it, was whether the companies were bound to make returns. The word depreciation and what it means in this act are to my mind not vitally important here. I do not base my decision upon the meaning of that word, nor upon its use in the act, but rather upon the meaning which should be given to the words gross income. Those are the words used in the act, together with the words "net income", and "earnings". The words gross receipts were not used in this act, as they were in the case of the Spreckles Sugar Refining Co. vs. McLain, 192 U. S. 397, nor are the words used here "deposits", as was the word used in Society for Savings vs. Coite, 6 Wall. 594. What was intended by the use of the words gross income? What does the word income mean? In ordinary speech people recognize a difference between capital and income. I believe that the ordinary meaning attached to income, when it is not derived from personal exertion, is that it is something produced by capital without impairing that capital, and which leaves the property intact, and that nothing can be called income for the purpose of this act, which takes away from the property itself. If it does, then it ceases to be income, and amounts to a sale of capital assets. This definition of the word income I
181 think is deducible from what was said in Flint vs. Stone Tracy Company, although it is not so distinctly stated. On page 146 the court said:

"The income is not limited to such as is received from property used in the business, strictly speaking".

That necessarily means that the property itself remains in the business, and continues to be used in the business, and that income was something that was derived from the use of it, leaving the property intact. On page 165 the Court said:

"It is no objection that the measure of taxation is found in the income produced in part from property which of itself considered is non-taxable".

It is important to notice that in that connection the court was speaking of government bonds which are not taxable. Income derived from government bonds is money derived from them without impairing the capital which produced it.

It follows necessarily from the views which I have expressed, that the words "gross income" do not mean "gross receipts". It is apparent to me that gross income can not mean gross receipts. Take, for example, the case of a mercantile corporation. It has property at the beginning of the year worth $100,000. During the year it sells at retail $10,000 of that property at what it cost. Then in the last month of the year, in December, it sells the entire property which it has left for $90,000, so that its gross receipts for the year are $100,000. It cannot be possible that such a corporation is bound to pay this tax on $100,000. Having sold $10,000 at no profit, it ought not to be subject to any taxation on that. As to the $90,000, that is money derived from a sale of capital assets. It is simply a change in the form of the capital; the merchandise has become money. If that $90,000 is taxable under this act, it can only be on the theory that congress intended to put a tax upon the transfer of property. I do not doubt the power of con-
182 gress to do that, but when the court decided in the Flint case that this was a tax upon the privilege of doing business in a corporate capacity, it expressly decided that it was not a tax upon the transfer of property. I will refer again to the illustration which I have given. I will modify it by assuming that the corporation sold the $90,000 in question for $80,000; that is, that the merchandise cost it $90,000 and it sold it for $80,000. That $80,000 must figure in its gross receipts for that year. But it lost $10,000 during the year, instead of making $90,000. It is perfectly apparent from the language of the act, that it was never the intention of congress to impose a tax upon a corporation that was not making money; it was never its intention to tax a losing business.

Coming to the regulations made by the Commissioner of Internal Revenue, it will be noticed that the words "gross receipts" are nowhere used in the act or in the regulations. On the contrary, the following statement is found in Article 2, Section 5:

"It will be noted from these definitions that gross income is practically the same as gross profits."

An examination of the rules given for the determination of the gross income of different kinds of corporations shows that it was never in the mind of the Commissioner to make the gross receipts the foundation for a determination of the gross income.

In the same Article 2, Sec. 5 there is found the following:

"Sale of capital assets. In ascertaining income derived from the sale of capital assets, if the assets were acquired subsequent to January 1, 1909, the difference between the selling price and the buying price shall constitute an item of gross income to be added to or subtracted from gross income according to whether the selling price was greater or less than the buying price. If the capital assets were acquired prior to January 1, 1909, the amount if increment or depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909, and which
183 proportion shall be deducted from or added to the gross income for the year in which the sale was made."

This indicates that it is not money derived from capital that is to be taxed, but only that part of it which can be in some manner determined to be profits.

That this ore in place is capital, and is part of the real estate, I think admits of no question. It is just as much a part of the real estate as trees standing on the land.

Let us suppose that John S. Pillsbury & Company when it owned this land with the timber still standing thereon was a corporation, that in 1908 it sold the timber with the privilege of removing it within ten years, and that in 1909, 1910 and 1911 the purchaser cut the timber and during these years paid the purchase price of it. Could it be said that the purchase price so received was income within the meaning of this act? I do not think that it could. It was not income, it was the property itself; and, as I said before, the trees standing on the land are no more a part of the realty than is the ore under the surface of the land. They are both capital, and money derived from a sale thereof can not be considered income, whether it be money received from the ore, or money received from the timber.

There are two cases, and only two, to which my attention has been called that have passed upon this question; one is United States vs. Nipissing Mines Company, 202 Fed., 803, where the conclusion was reached that money thus received was not income, and the other is Stratton's Independence vs. Howbert, decided in the District Court of Colorado. Of the cases cited in the opinion only two had to do with questions of taxation.

In King vs. Attwood, 6 Barn & Cres., 277, Attwood as the owner of a coal mine was assessed on a rate for the relief of the poor. But the act there construed (43 Eliz. c. 2) specifically made owners of coal mines rateable.'

184 The same is true of Coltness Iron Company vs. Black, 6 Law Rep. Appeal Cases, 315. Moreover, in that case it was said: "The intention of the act, it is abundantly clear, was in Schedule A to tax 'property'. If a man had bought an estate, the tax was intended to be paid by him on the annual value of that estate, without reference to where he got it, or how he got it, or how much he paid for it. So if a man built a house or bought a house, he was intended to pay tax on the annual Value of the house, no matter what it costs. Nor does anything turn upon the fact that the estate is a permanent and undecaying species of property while the house is a species of property of a less durable kind; he was intended to pay the tax upon it as long as it lasted. "What then is the case of a mine? In the Schedule A which is the schedule applicable to 'property', a 'mine' is in express terms included as a species of 'property', which is made the subject of a tax."

I attach no importance to the fact that the company used the word dividends in making this distribution. If the money was not gross income the fact that when they distributed it they called it dividends, could not in any sense change the law as to what the real character of the money was. Nor do I attach any importance to the fact that upon the books the companies carried no "depreciation" account.

I come now to the decision of the Commissioner which has been read by the District Attorney as a part of his argument. It seems to be based upon the theory that when the Sargent Company, for example, was organized in 1906 it bought the property for $108,000, that it was then worth much more than that sum, that this excess is being received annually by way of royalties, and that the portions received in 1909, 1910 and 1911 must be considered as profits, and therefore income to be taxed. The Commissioner seems to have made an attempt to apply to the case that part of the regulations heretofore quoted
185 under the heading "Sale of Capital Assets". This property was all acquired prior to January 1, 1909. In applying the rule, it is necessary for him to determine the proportion of the gain which arose subsequent to that date. There is no evidence to show what the value of this property was at any time before the incorporation, or at any time since. Yet it clearly appears that there has been no gain at all, so far as these plaintiffs are concerned, since 1909. All of the leases were

made prior to that date for terms of 50 years or more. The value the property to the plaintiffs was then fixed, and it could not be changed to their advantage during the terms of the leases. In other words, the property was worth no more to them in 1909, 1910 and 1911 than it was in 1906, 1907 and 1908.

The regulation relating to income from sale of capital assets is therefore by its express terms inapplicable to this case.

But the assumption that there was any profit even in 1906 is entirely unwarranted. The only basis for that assumption is the fact that the Sargent Company was organized with a capital stock of $108,000, which it issued for the land conveyed to it, and that the land is now worth much more than that amount.

It will be noticed that the amount of the capital stock was fixed a $108,000, because the smallest interest which any owner of the property had was one one hundred and eighth part of the whole. It is perfectly apparent from the evidence that $108,000 was selected as the value of the capital without any reference whatever to the value of the property. The value of the property was not then considered, and it is apparent that it could not have been, because at that time all the leases had been made, and it was then known that the value of the property was largely in excess of $108,000. It is evidence that taking $108,000 as the capital stock was a mere nominal capitalization, without any reference to value. It comes very near
in substance, as I thought when I heard the evidence,
186 to a corporation with shares without par value, such as
are allowed now by the laws of New York, as I understand. Take the illustration which I gave when Mr. Houpt was presenting his side of the case, a Bridge Company capitalized for $10,000, when the property itself cost a million dollars. Manifestly, it would be most unjust to say, for the purpose of taxing the company under the act, that it had made the difference between $10,000 and the cost of the bridge, simply because it had selected $10,000 as the amount of its capital stock. That sum was selected for its own convenience, without any reference whatever to the value of the property. If the Sargent Company had selected $108,000,000 as the amount of its capital stock instead of $108,000, would these receipts be taxable under this act? Evidently not, according to the theory of the Commissioner.

This case is to be decided upon what the actual facts are, and not upon what they appear to be. The actual facts are that nobody has made a dollar out of these properties by these in-

corporations. The evidence shows that the same persons own the stock now who owned the property before the corporations were organized. The mere change of form of ownership from that of these individuals to that of a corporation owned by the same individuals can not produce such large profits as are claimed here.

The only conclusion that I can come to on this branch of the case is, that this money was never received as gross income, and cannot be in any sense called income; that it was never taxable, and that the tax on it was wrongfully collected. I assume that there is no question about the amount, so that judgments can be rendered for the amounts claimed in the complaints. I do not propose to make special findings of fact. I shall make a general finding in each one of the cases for the plaintiff, and will order judgment for the amount claim-
187 ed. I think, Mr. Houpt, that you should make some requests for declarations of law.

Mr. Houpt: I would rather except to the ruling of the court holding that the receipt of royalties, as shown in this case, does not constitute gross income.

The Court: Note an exception.

Approved: Charles A. Willard.

(Certificate of Judge to Bill of Exceptions.)

I hereby certify that the foregoing is conformable to the truth and contains all the evidence introduced on the trial of said causes and all proceedings had upon the trial thereof; and inasmuch as the same constitutes no part of the record herein, the same is allowed and certified as and for the bill of exceptions herein.

Dated October 6th, 1913.

CHARLES A. WILLARD,
Judge.

Endorsed: Bill of Exceptions, Filed in the District Court on Oct. 6, 1913.

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188 Assignments of Error.

Sargent Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue,
Defendant.

And now comes the said defendant by Charles C. Houpt, his attorney, and says that upon the trial of said cause there was manifest error to the prejudice of the defendant in the following respects:

I.

The Court erred in refusing to hold and declare the law to be as stated in defendant's first request.

II.

The Court erred in refusing to hold and declare the law to be as stated in defendant's second request.

III.

The Court erred in refusing to hold and declare the law to be as stated in defendant's third request.

IV.

The Court erred in holding and deciding that the royalties received by the plaintiff as shown in the testimony did not constitute "gross income" within the meaning and intent of the Act of August 5, 1909.

V.

The Court erred in ordering and directing judgment for the plaintiff.

CHARLES C. HOUPT,
Attorney for Defendant.

Dated October 6th, 1913.

Endorsed: Filed in the District Court on Oct. 6, 1913.

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189 Assignments of Error.

Sutton Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

And now comes the said defendant by Charles C. Houpt, his attorney, and says that upon the trial of said cause there was manifest error to the prejudice of the defendant in the following respects:

I.

The Court erred in refusing to hold and declare the law to to be as stated in defendant's first request.

II.

The Court erred in refusing to hold and declare the law to be as stated in defendant's second request.

III.

The Court erred in refusing to hold and declare the law to be as stated in defendant's third request.

IV.

The Court erred in holding and deciding that the royalties received by the plaintiff as shown in the testimony did not constitute "gross income" within the meaning and intent of the Act of August 5, 1909.

V.

The Court erred in ordering and directing judgment for the plaintiff.

CHARLES C. HOUPT,
Attorney for Defendant.

Dated October 6th, 1913.

Endorsed: Filed in the District Court on Oct. 6, 1913.

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190 (Assignments of Error.)

Kearsarge Land Company, a corporation, Plaintiff,

vs.

Fred von Baumbach, Collector of Internal Revenue, Defendant.

And now comes the said defendant by Charles C. Houpt, his attorney, and says that upon the trial of said cause there was manifest error to the prejudice of the defendant in the following respects:

I.

The Court erred in refusing to hold and declare the law to be as stated in defendant's first request.

II.

The Court erred in refusing to hold and declare the law to be as stated in defendant's second request.

III.

The Court erred in refusing to hold and declare the law to be as stated in defendant's third request.

IV.

The Court erred in holding and deciding that the royalties received by the plaintiff as shown in the testimony did not constitute "gross income" within the meaning and intent of the Act of August 5, 1909.

V.

The Court erred in ordering and directing judgment for the plaintiff.

CHARLES C. HOUPT,
Attorney for Defendant.

Dated October 6th, 1913.

Endorsed: Filed in the District Court on Oct. 6, 1913.

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192 Petition for and Order Allowing Writ of Error.

Sargent Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

And now comes the said defendant by Charles C. Houpt, his attorney, and prays the allowance of a writ of error to remove the judgment and proceedings in this cause into the United States Circuit Court of Appeals for the Eighth Circuit, in order that defendant may have a review of said judgment in the said Circuit Court of Appeals, and that a citation to that end may issue to the plaintiff pursuant to the laws of the United States and the rules and practice of this Honorable Court.

CHARLES C. HOUPT,
Attorney for Defendant.

A writ of error in the above entitled cause is allowed as prayed for in the foregoing petition.

CHARLES A. WILLARD,
United States District Judge.

Dated October 6th, 1913.

Endorsed: Filed in the District Court on Oct. 6, 1913.

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193 Petition for and Order Allowing Writ of Error.

Sutton Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

And now comes the said defendant by Charles C. Houpt, his attorney, and prays the allowance of a writ of error to remove the judgment and proceedings in this cause into the United States Circuit Court of Appeals for the Eighth Circuit, in order that defendant may have a review of said judgment in the said Circuit Court of Appeals, and that a citation to that end may issue to the plaintiff pursuant to the laws of the United States and the rules and practice of this Honorable Court.

CHARLES C. HOUPT,
Attorney for Defendant.

A writ of error in the above entitled cause is allowed as prayed for in the foregoing petition.

CHARLES A. WILLARD,
United States District Judge.

Dated October 6th, 1913.

Endorsed: Filed in the District Court on Oct. 6, 1913.

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194 Petition for and Order Allowing Writ of Error.

Kearsarge Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

And now comes the said defendant by Charles C. Houpt, his attorney, and prays the allowance of a writ of error to remove the judgment and proceedings in this cause into the United States Circuit Court of Appeals for the Eighth Circuit, in order that defendant may have a review of said judgment in the said Circuit Court of Appeals, and that a citation to that end may issue to the plaintiff pursuant to the laws of the United States and the rules and practice of this Honorable Court.

CHARLES C. HOUPT,
Attorney for Defendant.

A writ of error in the above entitled cause is allowed as prayed for in the foregoing petition.

CHARLES A. WILLARD,
United States District Judge.

Dated October 6th, 1913.

Endorsed: Filed in the District Court on Oct. 6, 1913.

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195 (Order that no Execution Issue Against the Defendant.)

Sargent Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

It is hereby certified by the Court that the recovery in this cause against said defendant is for acts done by him as United States Collector of Internal Revenue, and that such action was taken under the direction of the United States Commissioner of Internal Revenue.

Wherefore, under the provisions of Section 989 of the Revised Statutes of the United States, it is Ordered that no execution issue in this cause against said defendant.

Dated this 6th day of October, 1913.

CHARLES A. WILLARD,
Judge.

Endorsed: Filed in the District Court on Oct. 6, 1913.

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196 (Order that no Execution issue against the Defendant.)

Sutton Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

It is hereby certified by the Court that the recovery in this cause against said defendant is for acts done by him as United States Collector of Internal Revenue, and that such action was taken under the direction of the United States Commissioner of Internal Revenue.

Wherefore, under the provisions of Section 989 of the Revised Statutes of the United States, it is Ordered that no execution issue in this cause against said defendant.

Dated this 6th day of October, 1913.

CHARLES A. WILLARD,
Judge.

Endorsed: Filed in the District Court on Oct. 6, 1913.

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197 (Order that no Execution issue against the Defendant.

Kearsarge Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

It is hereby certified by the Court that the recovery in this cause against said defendant is for acts done by him as United States Collector of Internal Revenue, and that such action was taken under the direction of the United States Commissioner of Internal Revenue.

Wherefore, under the provisions of Section 989 of the Revised Statutes of the United States, it is Ordered that no execution issue in this cause against said defendant.

Dated this 6th day of October, 1913.

CHARLES A. WILLARD,
Judge.

Endorsed: Filed in the District Court on Oct. 6, 1913.

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198 (Writ of Error in case of Sargent Land Co., filed in the District Court on Oct. 6, 1913.)

United States of America—ss.

The President of the United States of America, To the Honorable the Judges of the District Court of the United States, for the District of Minnesota, Third Division—Greeting:

Because, in the records and proceedings, as also in the rendition of the judgment of a plea which is in the said District Court, before you, at the June Term, 1913, thereof, between Sargent Land Company, a corporation, Plaintiff and Fred von Baumbach, Collector of Internal Revenue, Defendant manifest error hath happened, to the great damage of the said defendant as by his complaint appears,

We, being willing that error, if any hath been, should be duly corrected and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then, under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Eighth Circuit, together with this writ, so that you have the said record and proceedings aforesaid at the City of St. Louis, Missouri, and filed in the office of the Clerk of the United States Circuit Court of Appeals, for the Eighth Circuit, on or before the 5th day of December, 1913, to the end that the record and proceedings aforesaid, being inspected, the United States Circuit Court of Appeals may cause further to be done therein to correct that error, what of right and according to the laws and customs of the United States should be done.

Witness, the Honorable Edward D. White, Chief Justice, of the United States, this 6th day of October, A. D. 1913.

Seal
U. S. Dist. Court
Dist. of Minnesota.
Third Division

Issued at office in St. Paul, Minnesota, with the seal of the District Court of the United States, for the District [or] Minnesota, Third Division.

CHARLES L. SPENCER,
Clerk of the District Court of the United States, for the District of Minnesota.

Allowed by CHARLES A. WILLARD,
Judge.

Filed October 6th, 1913. Charles L. Spencer, Clerk.

United States of America,
District of Minnesota,
Third Division—ss.

In obedience to the command of the above writ, I herewith transmit to the United States Circuit Court of Appeals for the Eighth Circuit, a duly certified transcript of the record and proceedings in the within entitled cause, with all things concerning the same.

Seal
U. S. Dist. Court
Dist. of Minnesota.
Third Division

In Witness Whereof, I hereunto subscribe my name and affix the Seal of the District Court of the United States for the District of Minnesota, Third Division.

CHARLES L. SPENCER,
Clerk of the District Court of the United States, for the District of Minnesota.

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200 (Writ of Error in case of Sutton Land Co., filed in the District Court on Oct. 6, 1913.)

United States of America—ss.

The President of the United States of America, To the Honorable the Judges of the District Court of the United States, for the District of Minnesota, Third Division—Greeting:

Because, in the records and proceedings, as also in the rendition of the judgment of a plea which is in the said District Court, before you, at the June Term, 1913, thereof, between Sutton Land Company, a corporation, Plaintiff, and Fred von Baumbach, Collector of Internal Revenue, Defendant, manifest error hath happpened, to the great damage of the said Fred von Baumbach, Collector of Internal Revenue, as by his complaint appears,

We, being willing that error, if any hath been, should be duly corrected and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then, under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Eighth Circuit, together with this writ, so that you have the said record and proceedings aforesaid at the City of St. Louis, Missouri, and filed in the office of the Clerk of the United States Circuit Court of Appeals, for the Eighth Circuit,

on or before the 5th day of December, 1913, to the end that the record and proceedings aforesaid, being inspected, the United States Circuit Court of Appeals may cause further to be done therein to correct that error, what of right and according to the laws and customs of the United States should be done.

Witness, the Honorable Edward D. White, Chief Justice of the United States, this 6th day of October, A. D. 1913.

Seal
U. S. Dist. Court
Dist. of Minnesota.
Third Division

Issued at office in St. Paul, Minnesota, with the seal of the District Court of the United States, for the District [or] Minnesota, Third Division.

CHARLES L. SPENCER,
Clerk of the District Court of the United States, for the District of Minnesota.

Allowed by CHARLES A. WILLARD, Judge.

Filed October 6th, 1913. Charles L. Spencer, Clerk.

United States of America,
District of Minnesota, Third Division—ss.

In obedience to the command of the above writ, I herewith transmit to the United States Circuit Court of Appeals for the Eighth Circuit, a duly certified transcript of the record and proceedings in the within entitled cause, with all things concerning the same.

Seal
U. S. Dist. Court
Dist. of Minnesota.
Third Division

In Witness Whereof, I hereunto subscribe my name and affix the Seal of the District Court of the United States for the District of Minnesota, Third Division.

CHARLES L. SPENCER,
Clerk of the District Court of the United States, for the District of Minnesota.

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202 (Writ of Error in case of Kearsarge Land Co., filed in the District Court on Oct. 6, 1913.)

United States of America—ss.

The President of the United States of America, To the Honorable the Judges of the District Court of the United States, for the District of Minnesota, Third Division—Greeting:

Because, in the records and proceedings, as also in the rendition of the judgment of a plea which is in the said District

Court, before you, at the June Term, 1913, thereof, between Kearsarge Land Company, a corporation, Plaintiff, and Fred von Baumbach, Collector of Internal Revenue, Defendant, manifest error hath happened, to the great damage of the said Fred von Baumbach, Collector of Internal Revenue, as by his complaint appears,

We, being willing that error, if any hath been, should be duly corrected and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then, under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Eighth Circuit, together with this writ, so that you have the said record and proceedings aforesaid at the City of St. Louis, Missouri, and filed in the office of the Clerk of the United States Circuit Court of Appeals, for the Eighth Circuit, on or before the 5th day of December, 1913, to the end that the record and proceedings aforesaid, being inspected, the United States Circuit Court of Appeals may cause further to be done therein to correct that error, what of right and according to the laws and customs of the United States should be done.

Witness, the Honorable Edward D. White, Chief Justice of the United States, this 6th day of October, A. D. 1913.

Seal
U. S. Dist. Court
Dist. of Minnesota.
Third Division

Issued at office in St. Paul, Minnesota, with the seal of the District Court of the United States, for the District [or] Minnesota, Third Division.

CHARLES L. SPENCER,
Clerk of the District Court of the United States, for the District of Minnesota.

Allowed by CHARLES A. WILLARD, Judge.

Filed October 6th, 1913. Charles L. Spencer, Clerk.

United States of America,
District of Minnesota, Third Division—ss.

In obedience to the command of the above writ, I herewith transmit to the United States Circuit Court of Appeals for the

Eighth Circuit, a duly certified transcript of the record and proceedings in the within entitled cause, with all things concerning the same.

In Witness Whereof, I hereunto subscribe my name and affix the Seal of the District Court of the United States for the District of Minnesota, Third Division.

Seal
U. S. Dist. Court
Dist. of Minnesota.
Third Division

CHARLES L. SPENCER,
Clerk of the District Court of the United States, for the District of Minnesota.

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203 (Stipulation for Transmission to Court of Appeals of copies of Two Mining Leases, Plaintiffs' Exhibits 15 and 16.)

Sargent Land Company, a corporaton, Plaintiff,
vs.
Fred Von Baumbach, Collector of Internal Revenue, Defendant.

Kearsarge Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

Sutton Land Company, a corporation, Plaintiff,
vs.
Fred Von Baumbach, Collector of Internal Revenue, Defendant.

It is hereby stipulated and agreed by and between the parties to the above entitled actions that as part of the record herein the Clerk of said Court may certify and transmit to the Circuit Court of Appeals, Eighth Circuit, copies of the two mining leases introduced by plaintiffs on the trial of these causes, and that said leases, when so certified and transmitted, may be taken and be a part of the record herein for all the purposes and uses of the writs of error in said cases; that the object of this stipulation is to avoid what is deemed to be the unnecessary expense of incorporating said leases in the printed record.

SNYDER & GALE,
JOHN R. VAN DERLIP,
Attorneys for Plaintiffs.

CHARLES C. HOUPT,
United States Attorney and
Attorney for Defendant.

Endorsed: Filed in the District Court on Oct. 6, 1913.

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205 Citation.

Sargent Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

The United States of America to the Sargent Land Company, a corporation—Greeting:

You are hereby cited and admonished to be and appear in the United States Circuit Court of Appeals for the Eighth Circuit at the City of St. Louis, Missouri, sixty (60) days from and after the day this citation bears date, pursuant to a writ of error filed in the Clerk's office of said District Court for the District of Minnesota, Third Division, wherein the Sargent Land Company, a corporation, is plaintiff and Fred von Baumbach, Collector of Internal Revenue, is defendant, to show cause if any there be why the judgment and sentence therein against said defendant, as in said writ mentioned, should not be corrected, and why speedy justice should not be done the parties in that behalf.

Witness: The Honorable Charles A. Willard, Judge of said District Court, this 6th day of October, A. D., 1913.

CHARLES A. WILLARD,
Judge.

206 Endorsed: Due and personal service of the within citation is hereby admitted this 7 day of October, 1913.

SNYDER & GALE,
J. R. VAN DERLIP,
Attorneys for Plaintiff.

Filed in the District Court on October 13, 1913.

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208 Citation.

Sutton Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

The United States of America to the Sutton Land Company, a corporation—Greeting:

You are hereby cited and admonished to be and appear in the United States Circuit Court of Appeals for the Eighth Circuit at the City of St. Louis, Missouri, sixty (60) days from and after the day this citation bears date, pursuant to a writ of error filed in the Clerk's office of said District Court for the District of Minnesota, Third Division, wherein the Sutton Land Company, a corporation, is plaintiff and Fred von Baumbach,

Collector of Internal Revenue, is defendant, to show cause, if any there be, why the judgment ~~and sentence~~ therein against said defendant, as in said writ mentioned, should not be corrected, and why speedy justice should not be done the parties in that behalf.

Witness: The Honorable Charles A. Willard, Judge of said District Court, this 6th day of October, A. D., 1913.

CHARLES A. WILLARD,
Judge.

209 Endorsed: Due and personal service of the within citation is hereby admitted this 7 day of October, 1913.

SNYDER & GALE,
J. R. VAN DERLIP,
Attorneys for Plaintiff.

Filed in the District Court on October 13, 1913.

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211 Citation.

Kearsarge Land Company, a corporation, Plaintiff,
vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

The United States of America to the Kearsarge Land Company, a corporation—Greeting:

You are hereby cited and admonished to be and appear in the United States Circuit Court of Appeals for the Eighth Circuit at the City of St. Louis, Missouri, sixty (60) days from and after the day this citation bears date, pursuant to a writ of error filed in the Clerk's office of said District Court for the District of Minnesota, Third Division, wherein the Kearsarge Land Company, a corporation, is plaintiff and Fred von Baumbach, Collector of Internal Revenue, is defendant, to show cause, if any there be, why the judgment ~~and sentence~~ therein against said defendant as in said writ mentioned, should not be corrected, and why speedy justice should not be done the parties in that behalf.

Witness: The Honorable Charles A. Willard, Judge of said District Court, this 6th day of October, A. D., 1913.

CHARLES A. WILLARD,
Judge.

212 Endorsed: Due and personal service of the within citation is hereby admitted this 7 day of October, 1913.

SNYDER & GALE,
J. R. VAN DERLIP,
Attorneys for Plaintiff.

Filed in the District Court on October 13, 1913.

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213 (Praecipe for Transcript and Election as to Printing.)

Sargent Land Company, a corporation, Plaintiff,
No. 715. vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

Sutton Land Company, a corporation, Plaintiff,
No. 716. vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

Kearsarge Land Company, a corporation, Plaintiff,
No. 717. vs.
Fred von Baumbach, Collector of Internal Revenue, Defendant.

To the Clerk of said Court:

The undersigned, Attorney for the defendant in the above entitled causes, hereby files in the office of said Clerk this notice of the election of said defendant to take and file in the office of the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, to be printed under the supervision of the Clerk of said Circuit Court of Appeals, under its rules, a transcript of the record in said causes; and the Clerk of said District Court is hereby required to make and transmit to said Circuit Court of Appeals one transcript of the record in said causes, as follows:

Certified transcript of:

Complaint in cause No. 715,

Complaint in cause No. 716,

Complaint in cause No. 717,

Amended Answer in cause No. 715,

Amended Answer in cause No. 716,

Amended Answer in cause No. 717,

Judgment for plaintiff in cause No. 715,

Judgment for plaintiff in cause No. 716,

Judgment for plaintiff in cause No. 717,

Stipulation in causes Nos. 715, 716 and 717,

Bill of Exceptions, with order allowing same, in causes Nos. 715, 716 and 717,

Assignments of Error in cause No. 715,

Assignments of Error in cause No. 716,

Assignments of Error in cause No. 717,

214 Petition for Writ of Error and order allowing writ in cause No. 715,

Petition for Writ of Error and order allowing writ in cause No. 716,

Petition for Writ of Error and order allowing writ in cause No. 717,

Order directing that no execution issue against defendant in cause No. 715,

Order directing that no execution issue against defendant in cause No. 716,

Order directing that no execution issue against defendant in cause No. 717,

Stipulation that two mining leases (Plaintiffs' Exhibits 15 and 16) may be certified and transmitted to Circuit Court of Appeals, &c.

Praecipe for transcript on writ of error and election as to printing, &c.

And the Clerk is hereby directed, in accordance with a stipulation mentioned herein and made a part of the record on the writs of error herein, to certify and transmit to said Circuit Court of Appeals copies of Plaintiffs' Exhibits 15 and 16 in said causes.

CHARLES C. HOUPT,

United States Attorney for the District of Minnesota and Attorney for defendant.

Endorsed: Filed in the District Court on Oct. 29, 1913.

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215 (Clerk's Certificate to Transcript.)

I, Charles L. Spencer, Clerk of said District Court, do hereby certify and return to the Honorable, the United States Circuit Court of Appeals for the Eighth Circuit, that the foregoing, consisting of 214 pages, numbered consecutively from 1 to 214, inclusive, is a true and complete transcript of all the records, process, pleadings, orders, final judgment and all other proceedings in said causes and of the whole thereof, as appears from the original records and files of said Court, to-wit: Complaint in cause No. 715, Complaint in cause No. 716, Complaint in cause No. 717, Amended Answer in cause No. 715, Amended Answer in cause No. 716, Amended Answer in cause No. 717, Judgment for plaintiff in cause No. 715, Judgment for plaintiff in cause No. 716, Judgment for plaintiff

in cause No. 717. Stipulation in causes Nos. 715, 716 and 717, Bill of Exceptions, with order allowing same, in causes Nos. 715, 716 and 717, Assignments of Error in cause No. 715, Assignments of Error in cause No. 716, Assignments of Error in cause No. 717, Petition for Writ of Error and order allowing writ in cause No. 715, Petition for Writ of Error and order allowing Writ in cause No. 716, Petition for Writ of Error and order allowing writ in cause No. 717. Order directing that no execution issue against defendant in cause No. 715, Order directing that no execution issue against defendant in cause No. 716, Order directing that no execution issue against defendant in cause No. 717, Stipulation that two mining leases, (Plaintiffs' Exhibits 15 and 16) may be certified and transmitted to Circuit Court of Appeals, &c., Praecipe for transcript on writ of error, election as to printing, &c.; and I do further certify and return that I have annexed to said transcript, and included within said paging, the original Citation, together with the proof of service thereof; and that separately, I do hereby transmit to said Circuit Court of Appeals duly certified copies of the two mining leases mentioned in the stipulation last aforesaid, in accordance with said stipulation.

In Witness Whereof, I have hereunto set my hand as the Clerk aforesaid, and affixed the seal of said Court, at St. Paul, in the District of Minnesota, this 29th day of October, A. D. 1913.

Seal
U. S. Dist. Court
Dist. of Minnesota
Third Division

CHARLES L. SPENCER,
Clerk.

Filed Nov. 8, 1913. John D. Jordan, Clerk.

Pleas and proceedings in the United States Circuit Court of Appeals for the Eighth Circuit, at the December Term, 1914, of said Court, before the Honorable Walter H. Sanborn and the Honorable John E. Carland, Circuit Judges, and the Honorable Henry T. Reed, District Judge.

Attest:

[SEAL.] (Signed) JOHN D. JORDAN,
Clerk of the United States Circuit Court of Appeals for the Eighth Circuit.

Be it Remembered that heretofore, to-wit: on the eighth day of November, A. D. 1913, a transcript of record pursuant to writs of error directed to the District Court of the United States for the District of Minnesota, were filed in the office of the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit in certain causes wherein Fred von Baumbach, Collector, etc., is Plaintiff in Error and the Sargent Land Company, a corporation, is Defendant in Error; wherein Fred von Baumbach, Collector, etc., is Plaintiff in Error and the Sutton Land Company, a corporation, is Defendant in Error, and wherein Fred von Baumbach, Collector, etc., is Plaintiff in Error and the Kearsarge Land Company, a corporation, is Defendant in Error, which said transcript as prepared and printed under the rules of the United States Circuit Court of Appeals for the Eighth Circuit, under the supervision of its Clerk, is in the words and figures following, to-wit:

And thereafter the following proceedings were had in the Circuit Court of Appeals, in said causes, viz:

(Appearance of Counsel for Plaintiff in Error, in Cause No. 4081.)

United States Circuit Court of Appeals,
Eighth Circuit. No. 4081.

Fred von Baumbach, Collector of Internal Revenue, Plaintiff in Error,

vs.

Sargent Land Company, a corporation.

The Clerk will enter my appearance as Counsel for the Plaintiff in Error.

Charles C. Houpt,
U. S. Attorney.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Nov. 8, 1913.

(Appearance of Counsel for Defendant in Error, in Cause No. 4081.)

The Clerk will enter my appearance as Counsel for the Defendant in Error.

Fred B. Snyder,
Edward C. Gale,
John R. Van Derlip.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Nov. 17, 1913.

(Appearance of Counsel for Plaintiff in Error, in Cause No. 4082.)

United States Circuit Court of Appeals,
Eighth Circuit. No. 4082.

Fred von Baumbach, Collector of Internal Revenue, Plaintiff in Error,

vs.

Sutton Land Company, a corporation.

The Clerk will enter by appearance as Counsel for the Plaintiff in Error.

Charles C. Houpt.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Nov. 8, 1913.

(Appearance of Counsel for Defendant in Error, in Cause No. 4082.)

The Clerk will enter my appearance as Counsel for the Defendant in Error.

Fred B. Snyder,
Edward C. Gale,
John R. Van Derlip.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Nov. 17, 1913.

(Appearance of Counsel for Plaintiff in Error, in Cause No. 4083.)

United States Circuit Court of Appeals,
Eighth Circuit. No. 4083.

Fred von Baumbach, Collector of Internal Revenue, Plaintiff in Error,

vs.

Kearsarge Land Company, a corporation.

The Clerk will enter my appearance as Counsel for the Plaintiff in Error.

Charles C. Houpt.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Nov. 8, 1913.

(Appearance of Counsel for Defendant in Error, in Cause No. 4083.)
The Clerk will enter my appearance as Counsel for the Defendant in Error.

Fred B. Snyder,
Edward C. Gale,
John R. Van Derlip.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Nov. 17, 1913.

(Order of Submission.)

United States Circuit Court of Appeals,
Eighth Circuit. May Term, 1914.
Monday, May 11, 1914.

Fred von Baumbach, Collector, etc., Plaintiff in Error,
No. 4081. *vs.*
Sargent Land Company.
In Error to the District Court of the United States for the District of Minnesota.

Fred von Baumbach, Collector, etc., Plaintiff in Error,
No. 4082. *vs.*
Sutton Land Company.
In Error to the District Court of the United States for the District of Minnesota.

Fred von Baumbach, Collector, etc., Plaintiff in Error,
No. 4083. *vs.*
Kearsarge Land Company.
In Error to the District Court of the United States for the District of Minnesota.

The above causes having been called for hearing in their regular order, the same were argued as one case, whereupon, argument was commenced by Mr. Charles C. Houpt for plaintiffs in error, continued by Mr. John R. Van Derlip for defendants in error and concluded by Mr. Charles C. Houpt for plaintiffs in error. Thereupon, these causes were submitted to the Court on the transcript of record from said District Court and the briefs of counsel filed herein.

[Opinion.]

United States Circuit Court of Appeals, Eighth Circuit, No. 4081.
December Term, A. D. 1914.

Fred von Baumbach, Collector of Internal Revenue, Plaintiff in Error,
vs.
Sargent Land Company, a corporation, Defendant in Error.

Fred von Baumbach, Collector of Internal Revenue, Plaintiff in Error,
No. 4082. *vs.*
Sutton Land Company, a corporation, Defendant in Error.

Fred von Baumbach, Collector of Internal Revenue, Plaintiff in Error,

No. 4083. *vs.*

Kearsarge Land Company, a corporation, Defendant in Error.

In Error to the District Court of the United States for the District of Minnesota.

Mr. Charles C. Houpt, United States Attorney, appeared for plaintiff in error.

Mr. John R. Van Derlip (Mr. Fred B. Snyder and Mr. Edward C. Gale, were with him on the brief), for defendants in error.

Before Sanborn and Carland, Circuit Judges, and Reed, District Judge.

Syllabus.

1. Internal revenue—Corporation tax—Income.

The owners of lands practically valuable only for the ore in them, years before January 1, 1909, when the corporation tax act took effect, made mining leases thereof by which they granted the absolute right to dig and have the ore therein and to remove it within long terms, such as 25 and 50 years, and the lessees covenanted to pay yearly fixed amounts, such as 25 or 30 cents a ton for the ore extracted, and minimum yearly amounts to be credited on ores subsequently extracted in case sufficient amounts were not extracted to come to the minimums in any year. Thereafter, in the year 1906, these owners for the purpose of collecting their claims against the lessees under their covenants to pay for the ores and for the purpose of converting their property into money and distributing it among themselves, organized three corporations, conveyed these claims and the land to them in three lots, one lot to each corporation, and took from them therefor all the stock of these corporations in proportion to their undivided interests in the property. The corporations engaged in no mining, or trading, or other like business, but confined their operations to collecting the claims against the lessees, protecting and preserving the property, converting it into money and distributing the proceeds among its stockholders. In 1909, 1910 and 1911 the corporations collected the amounts which fell due in those years on the claims against the lessees under their covenants in the leases which amounted to several hundred thousand dollars, and received some small amounts for the sale of some stumpage and a few town lots.

Held: The amounts thus received by the corporations were not included in income within the meaning of that word in the corporation tax act, but were parts of the property or capital of the corporations in a different form.

2. Same—Depreciation.

If the amounts collected by the corporations on the claims against the lessees under their covenants were income then the property or capital of the corporations was reduced in amount and value by those amounts and the corporations were entitled to an allowance thereof for the depreciation of their property.

3. Same—Doing business.

Corporations that are the owners of property not engaged in business with themselves, that are engaged in no mining, trading, or other like business, but confine their operations to acts necessary or incidental to the protection and preservation of their property, to its conversion into money and the distribution thereof among its stockholders, are not "doing business" within the meaning of the corporation tax act and are not subject to the tax it prescribes.

4. Mining leases—When sales of the ore.

Mining leases whereby the lessees are granted the absolute and exclusive right to extract and have the ore in the land and to remove it during terms, such as 25 and 50 years, so long as to be practically equivalent to unlimited times, are in reality sales of the ore and the royalties reserved in the leases are in fact the purchase prices thereof.

5. Right judgment for wrong reason not reversible.

A right judgment which is warranted by the record and the facts and was rendered without error in the trial or rendition, may not be reversed on the sole ground that the trial court gave a wrong reason for the just judgment.

Statement.

These writs of error are sued out to reverse judgments against the Collector of Internal Revenue for the recovery of moneys which he exacted from the three corporations, plaintiffs below, over their protest as excise taxes for the years 1909, 1910 and 1911, under the corporation tax act of August 5, 1909, 36 Stat. 111, 112, Chap. 6, Sec. 38. The court below found and held that the Commissioner had measured these taxes by the amounts of the receipts by the corporations of moneys derived by them from the conversion of parts of their respective properties or capitals into money instead of by their receipts from their gains or incomes as required by the act.

Many years before that act was passed these corporations had become, and were at the time it went into effect, and during the years 1909, 1910 and 1911, the owners of lands on the Mesaba Range which were valuable only for the iron ore in them beneath the surface and of the rights to collect and receive the portions of the royalties on the ore which came due during those years under mining leases whereby the ore had all been granted to lessees prior to the year 1908 for fixed prices per ton of the ores extracted and yearly minimum amounts. The receipts of moneys during those years by which the Commissioner measured the taxes consisted of the payments of amounts of these royalties which came due during those years and of a few sums so small and insignificant as to be negligible in the discussion of the issues here for decision which were received from the sale of a few town lots and lands and a little stumpage. From the sum of the receipts from these sources the Commissioner deducted nothing for depreciation of the plaintiffs' property or for conversion of parts of that property into money or for anything else except the expenses of the corporations, the taxes they paid and the five thousand dollars specified by the act itself. For example, he found the receipts of the Sargent Company from the collection in 1909 of the royalties on the

es, the sales of lots and lands and stumpage to be $395,732.90; from is amount he deducted only $5,458.83, the expenses of operating the rporation and $540.38 taxes paid by it during the year and the five ousand dollars specified in the act which left $384,733.69, and he used one per cent of this amount to be collected as the excise tax on the corporation. The amounts collected of each of the companies for each of the years were measured and found on the same sis and it is these amounts which the court below found that the mpanies were lawfully entitled to receive back.

The errors assigned are that the court should have found and held at the royalties received by the companies during the years 1909, 10 and 1911 constituted gross income of the companies during those ars and that the Commissioner was authorized to collect one per nt thereof without any deduction for the depreciation of the property or capital by the collection of these royalties or the conversion parts of their capital into money and the distribution of the proeds to the stockholders of the companies.

The facts material to the questions now at issue in this case are ese: The companies are not and never have been mining companies; they never have operated any mines in any way; they ver made but one lease and the terms of that lease were agreed on before the corporation lessor was organized and after its ganization it signed the legal contract on these terms. These rporations are and always have been mere owners of the rights collect from the lessees the fixed amount per ton of ores mined the lessees under leases made before the corporations were orized and of the lands leased whose only substantial value was value of the ore therein. The origin of these corporations, the rpose of their organization and existence and the character and ent of their operation are disclosed by the following facts: In years between 1870 and 1880, George A. Pillsbury, John S. lsbury and Charles A. Pillsbury became the owners of immense cts of timber land in Minnesota from which they removed and l the timber. John M. Longyear and Russell M. Bennett, about 0, procured an option from them for such lands, exclusive of timber thereon, as they might select on account of the ore rein. After exploration they selected the lands now held by the ee companies and pursuant to the contract for the option these ds were so deeded in 1892 that the parties above named thereby ame the owners of the following undivided interests in them: nett, one-fourth; Longyear, one-fourth; J. S. Pillsbury, one-h; George A. Pillsbury, one-sixth and Charles A. Pillsbury, -sixth. By the year 1906 all three of the Pillsburys had died their interests in this property had been devised or had descended nany parties so that the interests of some of the owners were small as 1/108th. The original parties and their successors in rest had made all the leases ever made on the property but one had agreed upon the terms of that one. It had become very cult to get legal deeds or contracts from all of the owners on unt of the minority of some, the age and location of others. se owners were not operating mines or doing anything with property but that which was necessary to sell it, convert it money and distribute the proceeds among themselves. The

money or the depreciation of the values of their property by these collections and the distribution of the amounts they received to their stockholders.

Sanborn, Circuit Judge, after stating the facts, delivered the opinion of the Court.

For doing business in a corporate capacity the Tax Corporation Act of August 6, 1909, 36 Stat. 112, Sec. 38, imposes upon every corporation organized for profit having capital stock represented by shares an annual excise tax equivalent to one per cent of its net income above $5,000.00. It provides that such net income shall be ascertained by the deduction from "the gross amount of the income of such corporation * * * received within the year from all sources" by it (1) its expenses of operation paid out of income, (2) its losses including a reasonable allowance for the depreciation of its property, (3) certain interest paid by it, (4) taxes paid by it and (5) dividends on stock of corporations subject to the excise tax. The basis of the standard or measure by which the amount of the tax is to be determined is "the gross amount of the income of such corporation * * * received within the year from all sources," not the gross amount received by the corporation from all sources, and from this amount of its income is to be deducted its expenses paid out of its income, not any expenses paid out of its capital or property, and an allowance for depreciation of its property. That the word income in this act is not synonymous with the word receipts and that it does not include receipts from the conversion without gain or profit of any part of the property of the corporation into money, or into any other form, is demonstrated by the fact that this word income appears in the clause "the gross amount of the income of such corporation" and segregates and designates a specific part and not all of the receipts of the corporation as the basis of the measure of the tax, by the fact that only those expenses paid out of income, none of those paid out of capital or property, are to be deducted, by the fact that a deduction for depreciation of property is to be made, by the evident purpose and the whole tenor of the act. This word income is used throughout the statute in contradistinction to property or invested capital, and it was neither the intention of the Congress nor is it the legal effect of the Act to impose any tax on account of the amounts received by a corporation that is not engaged in the business of buying, selling or trading in property, from the conversion of its property without gain into money or into any other form. These corporations were never engaged in any such business. And it is not doubtful that the small amounts of money received by them from the sales of the lots and lands that were conveyed to them at their organization in 1906 were not income but were mere proceeds of parts of their property on account of which they could not be lawfully taxed.

But were the royalties which had been owing to these corporations by the lessees since 1906 and which these corporations collected and received in 1909, 1910 and 1911, as they fell due, income by the amount of which the taxes upon them must be measured under the tax act, or were they the mere proceeds of the conversion without

gain or profit of parts of their property into money and no part of the measure of their lawful tax? The lands and hence the property of the corporations had no substantial value without the rights to collect the royalties the lessees had covenanted to pay. The leases had been made by the former owners prior to 1907 and if there was any gain, profit or income from the making of the leases that income accrued years before the tax act took effect and the corporations are exempt from any taxation on account of it. The lessors by the leases granted to the lessees the exclusive right to dig, remove and have all the iron ore in the lands and the right to remove it during terms such as 25 or 50 years, so long in fact that they were in effect a grant of the right to take it without limit of time or quantity. The lessees had covenanted to pay annually certain fixed amounts such as 25 cents or 30 cents a ton for the ore they extracted and to pay fixed minimum amounts every year whether they extracted ore or not which were contracted to be and were credited on their liability for ore subsequently taken whenever in any year they failed to extract sufficient ore to come to the minimum amounts. In 1906 and 1907 these corporations took from the lessors the latters claims and rights to collect and receive from the lessees the royalties they had covenanted to pay for the ore, and the title to the lands and issued their stock therefor. If there was any gain, profit or income in this transaction it was made in 1906 and 1907, at least two years before January 1, 1909, when the tax act took effect, and the corporations were exempt from taxation on account of that income. *Merchants Ins. Co.* v. *McCartney*, 17 Fed. Cases No. 9443, page 46. On January 1, 1909, when the Act took effect and for years before that date, these corporations were the owners of the claims and rights to collect and receive the amounts which the lessees had covenanted by the leases to pay for the ore in the lands and of the lands themselves. These things were their absolute property on January 1, 1909, and none of them was any part of their subsequent income, gain or profit. The land was practically worthless; the rights and claims to collect the amounts the lessees had covenanted to pay for the ores were practically all there was of value in their property and these were worth hundreds of thousands of dollars. If they had sold these claims in 1909 for cash for their actual value for no more and no less than their actual value, no part of that cash could have been gain, profit or income. It could not have escaped being a mere different form of their property, of their capital and the corporations could not have been taxable on account of it. If prior to 1909 A had bought promissory notes secured by mortgages worth their face payable without interest during the years 1909, 1910 and 1911, and had collected them during those years, the moneys thus collected could not have been his gain, profit or income. It could not have escaped being simply a different form of his property or capital. If in 1906 the owner of land had sold it for the promissory notes of B secured by mortgages worth their face payable without interest ten per cent annually during ten years and had contracted to convey the land upon the payment of the notes, and A had purchased the notes prior to 1909 and had collected the amounts due on them during the years 1909, 1910 and 1911, the moneys so paid could not have been income. They must

have been but a part of A's property in another form for the amount and value of his property would be the same the moment after he collected any of them that it was the moment before. The only difference would have been that the moment before it would all have been in notes and the moment after part of it would have been in notes and part of it in cash. So when the parts of the rights and claims of these corporations which the lessees covenanted by the leases to pay for the ores came due and were received by the corporations in 1909, 1910 and 1911, the value of their property was neither increased nor diminished. The amount and the value of their unpaid claims was diminished by the amount that the value of their cash was increased by the payments and the moneys received became a part of their property.

In the application of this tax act to the numberless and varied situations which different cases present, the actual facts of each case and their real consequences must be considered and given legitimate effect regardless of misleading names and forms. The fact that the amounts which the lessees covenanted to pay are called rents or royalties in the leases or elsewhere must not be permitted to blind us to the true nature of the transactions which those leases evidenced. They were negotiated and all but one of them was executed by the individual owners of the lands prior to 1907. The land, including the right to the ore in it, was worth hundreds of thousands of dollars. Without the right to the ore it was worth practically nothing. By the leases the owners of the land granted to the lessees the absolute and exclusive right to take out and have all the ore in the land and to remove it at any time within 25 to 50 years, a time so long that it was ample to enable them to remove all of it and was equivalent to an unlimited time, and the lessees agreed to pay the yearly fixed amounts per ton for all the ore they should take and to pay the minimum amounts annually whether the ore was taken or not. The result was that the lessors granted a part of the corpus of the property, that by the grant the lessees were made the owners of the ore and the lessors the owners of the claims and of the rights to collect the amounts the lessees covenanted to pay for the ores and the transactions were in reality sales of the ore for covenants to pay the purchase price thereof. A mining lease whereby the lessee is granted the absolute and exclusive right to dig for, remove and have the mineral in the land during terms sufficiently long to enable him to remove it is in reality a sale of the ore and the royalties reserved are in fact the purchase price of it. Stoughton's Appeal, 7 Norris (88 Pa. St.) 198, 201, 202; *Scranton* v. *Phillips*, 94 Pa. St. 15, 22; *Coltness Iron Co.* v. *Black*, 6 Appeal Cases 315, 335, where Lord Blackburn says: "It was said by Lord Cairns in *Gowan* v. *Christie*, 3 Ex. D. 23, that a lease of mines 'is not in reality a lease at all in the sense in which we speak of an agricultural lease. There is no fruit; that is to say, there is no sowing and reaping in the ordinary sense of the term and there are no periodical harvests. What we call a mineral lease is really, when properly considered, a sale out and out of a portion of the land.' I think this is a perfectly accurate statement." Eley's Appeal, 103 Pa. St. 300; *Delaware, L. & W. R. R. Co.* v. *Sanderson*, 1 Atl. 394, 396; Hope's Appeal, 3 Atl. (Pa.) 23; *Caldwell* v. *Fulton*, 7 Casey (Pa.) 475; *Harlan* v. *Lehigh Coal & Navigation*

Co., 35 Pa. St. 287, 292; *Tiley* v. *Moyers*, 43 Pa. St. 404, 410; *Fairchild* v. *Fairchild*, 9 Atl. (Pa.) 255, 257. It is true that there is a decision in apparent conflict with this rational and established rule, *State* v. *Evans*, 99 Minn. 220, 223, 225, 227. But that was a decision *ex necessitate* and its effect must be limited to its special facts. The constitution of Minnesota prohibited any sale of any part of the school or swamp lands of the state otherwise than at public sale. A statute of the state had authorized mining leases of these lands. The state had made leases of many of them upon the faith of which more than $2,400,000 had been invested, when one of them was assailed on the ground that the statute was unconstitutional and the lease was void. Thereupon the court saved the leases and the statute on the grounds that if there was any doubt of the constitutionality of the law it was their duty to uphold it, that the state officers had acted upon the theory that it was valid, that it had been before the Supreme Court four times and they had rendered decisions based upon it without any challenge of its constitutionality and that it was not so clear that it was unconstitutional that it was their duty to strike it down. That decision is not persuasive in the case at bar.

If the purchase price of the ores called royalties in the leases ever became income it must have been when the leases were made. But the truth is that the leases merely changed the form of the property of the lessors from the ores to the rights and claims to the purchase price of the ores which the lessors covenanted to pay under the name of royalties, and the receipts by the corporation of the payments of the parts of those claims which fell due in 1909, 1910 and 1911 were but another substitution of the cash received for the parts of the claims paid. If the sums paid were gain, profit or income they might have been withdrawn and expended by the corporations without diminishing the value or amount of their property, but the claims are in fact diminished in amount and value by the amounts paid on them and the property of the corporations is depreciated by the same amounts unless the moneys so paid are substituted for the parts of the claims paid and remain the property of the corporations. As the claims are paid their amounts and their values decrease.

All the ores sold by some of the leases has already been extracted, the claims for its purchase price or royalties have been paid in full and the claims for them have become worthless. The ore under one of the leases was exhausted in 1911 and the claim for its purchase price or royalties then became worthless. If the amounts paid under the name of royalties for the ore taken under the exhausted leases had been income the claims for the royalties would still have been of their original value notwithstanding the payments, and the same is true of claims which have been paid in part only. These considerations compel the conclusion that these payments on the claims were not income but parts of the capital of the corporations.

There is another view of these cases sustained by the record that leads to the same conclusion. The proof is plenary and uncontroverted that the sole purpose of the owners of the claims for the royalties and purchase price of the ores and of the lands in organizing the corporations and making them the owners thereof was to collect by means of them those claims, convert the property into money

and distribute it among the grantors to the corporations, that this was the sole purpose of the stockholders of the corporations and their directors and officers in receiving the ownership of the property and that the corporations have confined their operations to so converting into money and distributing the proceeds of this property. The reason for these acts was that the interests of the owners were undivided, that they were so numerous and of such ages and conditions that a partition of the property in kind or by a conversion into money and a distribution of it had become imperative and the owners determined to effect it. Any one of these owners had the equitable right to such a partition. If one or more of them had petitioned the proper court for such relief and the court had appointed a receiver or master to collect the claims for the purchase price of the ore or royalties and to convert the property into money and distribute it among the owners according to their respective interests, could any court lawfully have held that the proceeds thus obtained were the gain, profit or income of the equitable owners? These corporations stood in the same relation to the claimants for the purchase price of the ore, or the royalties and the moneys they collected from them, and to the equitable owners of the property, their stockholders, that such a receiver would have stood. In reality they received and held these claims and the moneys collected from them in trust to distribute them among the equitable owners of the property, and the moneys they have collected were no more the income of the corporations or of their stockholders than is any part of the claims that are not collected or any other part of their property. Those collections were simply another form of the property of the corporations and of the stockholders substituted for the parts of the claims paid. The considerations which have now been stated have convinced that there was no error in the decision of the court below that the moneys collected by the corporations in 1909, 1910 and 1911 under the mining leases on the claims for the royalties on or the purchase price of the ore were not either gross or net income within the meaning of the tax act and that corporations that were, when the corporation tax act took effect on January 1, 1909, the owners of claims purchased years earlier for royalties on ores under mining leases made by their grantors whereby the absolute right to dig and have all the ore in the lands leased, which without the ore were worthless, and to remove it at any time during terms so long as to be equivalent to an unlimited time was granted to lessees and they covenanted to pay therefor yearly fixed amounts per ton for the ore extracted and minimum amounts yearly to be credited on ore subsequently removed in case sufficient to come to the minimum was not extracted in any year, are not taxable on account of the amounts coming due and received by the corporations in partial payment of those claims during the years 1909, 1910 and 1911 where their property was formerly owned and was conveyed to them by their original stockholders and the sole purpose of the conveyance and of their organization was to enable them to collect these claims, to convert the property conveyed to them into money and to divide the proceeds among their stockholders and the corporations have not engaged in mining, trading, or any other business but have strictly confined their operations to the accomplishment

of that purpose. *Stevens* v. *Hudson's Bay Co.*, 101 Law Times Reports 96, 97, 98, 99; *Foley* v. *Fletcher*, 3 H. & N. 769, 774, 778, 783, 787; *Secretary of State for India* v. *Scoble*, 89 Law Times Rep. 1, 3; *Tiley* v. *Moyers*, 43 Pa. St. 404, 410; *Gibson* v. *Cooke*, 1 Metc. (Mass.) 75.

Before assenting to these conclusions the arguments of counsel for the United States and the following authorities cited by him were read and considered:

Stratton's Independence Limited v. *Howbert*, 231 U. S. 399. But the decision in that case rests on the conceded proposition that a corporation that is engaged in mining its own property is presumed to be using its property or capital and the labor it employs in the business of mining for profit or income and that the proceeds of that business less its expenses must be presumed, in the absence of evidence to the contrary, to contain gain or income derived by the company from the business of mining from which a reasonable allowance for depreciation of the property may be deducted to find the net income which exactly measures its tax. The extent of that decision was (1) that corporations actively engaged in the business of mining their own property are subject to the corporation tax, (2) that the proceeds of ores mined by a corporation from its own premises includes presumptive gain or income from its mining business and are therefore included in its gross income within the meaning of the tax act and (3) that the allowance to be made for the depreciation of its property by reason of the extraction of the ore so mined is not the exact difference between the proceeds of the mining less the expenses thereof because such an allowance excludes the possibility of gain from, the mining business the existence of which is presumed. Pages 418, 421. The decision applies to the corporations that are the lessees and are conducting the business of mining the ores sold through these leases in the cases in hand, but it is inapplicable to the plaintiffs below because they do not and cannot get the gain or income from the mining which the lessees receive and they have not been and are not conducting the business of mining, or doing any other business for gain, but have been, were and are confining their operations to the collection of their claims and the conversion of their property into money and dividing its proceeds among the equitable owners thereof, their stockholders.

Flint v. *Stone Tracy Co.*, 220 U. S. 107, 145, 146, 170. In these cases the Supreme Court held that the rents received by a corporation engaged for profit in the business of owning and leasing taxicabs, or buildings, or ore lands constituted a part of its gross income within the meaning of the tax act. But the plaintiffs below never have been engaged in any such business. They never negotiated a mining lease. If there ever was any gain from owning and leasing any of their property it was made by their grantors more than two years before January 1, 1909, and had become a part of the property, the capital they were organized to and have confined themselves to converting into money and dividing among the equitable owners thereof, the *cestuis que trust*, and the facts of this case exclude them from the operation of the principles on which the Flint cases rest and from the effect of that decision.

Authorities to the effect that a devise of rents and profits of mineral lands with power to an executor to make leases thereof was intended by the testator to and did carry the royalties under such leases to the devisees. *Daly* v. *Beckett*, 24 Beavan's Rep. 114; Eley's Appeal, 103 Pa. St. 300, 305, 307; *McClintock* v. *Dana*, 106 Pa. St. 386; *Appeal of Shoemaker, et al.*, 106 Pa. St. 392; *Raynolds* v. *Hanna*, 55 Fed. 783, 800, 801. But these decisions are irrelevant to the construction of the corporation tax act or its application to the facts of this case, because the intent of the testator drawn from the terms of his will and his situation necessarily determined the decision in each case and the terms and purpose of each will was too far aside from the terms and object of the tax act and because the testators of these wills contemplated and authorized the business of mining by the executor by means of which he could make long or short leases. But the plaintiffs below neither mined nor made leases, but confined their operations to the mere collection of claims for royalties or the purchase price of the ores and the conversion of their property into money and its distribution, without gain to themselves, among those for whom they held it in trust before the corporation tax act took effect.

Authorities to the effect that a lessee corporation engaged in the business of mining is not forbidden by the general law that corporations conducting business for profit may not pay dividends out of capital from paying dividends out of the net proceeds of their mining business. *Lee* v. *Neuchatel Asphalte Co.*, 41 Chan. Div. 1, 27; *Excelsior Water & Min. Co.* v. *Pierce*, 90 Cal. 131, 140. But these decisions are inapplicable to the cases in hand for the same reasons as is the case of Stratton's Independence.

Authorities to the effect that the proceeds of the operation of mining and selling ore from lands owned or leased by the operating company less the expenses of operation are subject to taxes imposed by statute on "net earnings or income," or on "profits." *Commonwealth* v. *Ocean Oil Co.*, 59 Pa. St. 61, 63, 64; *Commonwealth* v. *Penn Gas Coal Co.*, 62 Pa. St. 241, 242; *Coltness Iron Co.* v. *Black*, 6 Appeal Cases 315, 335, 336; *People* v. *Roberts*, 156 N. Y. 585. But these decisions, like that of Stratton's Independence, apply only to companies actively engaged in the business of mining. The plaintiffs were not so engaged. They confined their operations strictly to the collection of claims against lessees for the purchase price of or royalties on the ore and the conversion of their property acquired years before the tax act took effect into money and its distribution among their stockholders, the equitable owners of it. They do not fall under the decisions in the cases cited by counsel for the United States nor under the rules or reasons on which they rest. They are far within the established principle that the collection of a good claim or the conversion of property by sale or otherwise into its true value in money, does not transform the proceeds into income, but merely substitutes them for the claim so collected or the property sold and leaves them in a different form, a part of the capital or property from which they were derived. A reading of the opinions of the courts, study and meditation on the terms and meaning of the tax act, on the facts of these cases and the reasons

for the propositions of counsel have convinced that such was the nature of the moneys received by the plaintiffs during the years 1909, 1910 and 1911 from their collections of their claims against the lessees for the purchase price of or the royalties on the ore, that those amounts were not a part of either the gross income or of the net income of the corporations and that the judgments of the court below were right.

It is interesting to note here, though, for the reasons stated, it is not material to the decision of this case, the ground upon which Lord Blackburn, who delivered the main opinion in the leading case of *Coltness Iron Co.* v. *Black*, 6 Appeal Cases 315, 330, 336, placed the decision in that case that the proceeds of an operating mining company were taxable as income under the English Income Tax Act. He did not place it on the ground that such proceeds were gains or profits, but on the ground that the statute which imposed a yearly tax "for every 20s. of the annual value thereof, the sum of seven pence," and provided that "the annual value of all the properties hereinafter described shall be understood to be the full amount for one year, or the average amount for one year, (and of the property of mines for five years) of the profits received therefrom within the respective times herein limited," must be construed in the light of previous English Tax legislation and practice to mean that the proceeds of the mines were the measure of this taxation. Pages 334, 335. In order to reach this conclusion he reviewed the history of English taxation from the times of Elizabeth and showed that long before any income tax was imposed coal mines were rated for taxation on the basis of their production, pages 330, 331, that this practice had been followed under the earlier statutes whether they imposed property or income taxes and from this long practice and this earlier legislation he drew the conclusion that such must have been the intention of the legislators who enacted the income tax statute and over-ruled an earlier decision to the contrary. Pages 335, 336. *Knowles* v. *McAdam*, 3 Ex. D. 23. Repeated readings of this opinion and the other opinions in that case lead to the conclusion that they are not even persuasive of the true interpretation and application of our corporation tax act because they are dominated by a long practice in taxation and a course of legislation that have never existed in this country.

There are still other reasons than those which have been stated why the judgments below should not be reversed. If there were error in the conclusion that the receipts of the companies from their collections of the amounts of their claims against the lessees which came due in 1909, 1910 and 1911 for the purchase price of or the royalties on the ore were not included in their gross income, if they were a part of that gross income, then the companies would have been entitled to "a reasonable allowance for depreciation of property" by the reduction of the values of their claims by these payments. *Stratton's Independence Limited* v. *Howbert*, 231 U. S. 399, 418. And as the payments on these claims unavoidably reduced and depreciated their value, as has been shown, by the amounts paid there would have been no net income from them on account of which an excise tax could have been lawfully exacted. *United States* v.

Nipissing Mines Co., 202 Fed. 803, 805; *Stevens* v. *Hudson's Bay Co.*, 101 L. T. Rep. 96, 97, 98.

Again, this excise tax was imposed on corporations for doing business in a corporate capacity. It is imposed on corporations "doing business" and on those only. Corporations that are the owners of property not used in business, that themselves engage in no trading, mining or other like business for gain, but confine their activities to acts necessary or incidental to the protection of their property and its conversion into money, are not "doing business" within the meaning of the corporation tax act. These companies were such owners during the years 1909, 1910 and 1911, and, as has been shown, they not only so confined their operations but in 1909 by an amendment of their articles of incorporation they disabled themselves from conducting any other operations or doing any business within the true interpretation of the tax act. They were not, therefore, taxable under that act and for that reason the judgments below are right. *McCoach* v. *Minehill Ry. Co.*, 228 U. S. 295, 305, 306, 309, 311; *Zonne* v. *Minneapolis Syndicate*, 220 U. S. 187, 190; *United States* v. *Nipissing Mines Co.*, 206 Fed. 431, 433, 434.

It is true that the court below took the opposite view of the last proposition and the companies sued out no writs of error. But there was no error in the course of the trial of the cases nor in the judgment, and a right judgment which is warranted by the record and the facts may not be reversed on the sole ground that the trial court gave a wrong reason for it. *Smiley* v. *Barker*, 83 Fed. 684, 687, 28 C. C. A. 9, 12; *Baker* v. *Kaiser*, 126 Fed. 317, 318, 61 C. C. A. 303, 304; *Buster* v. *Wright*, 135 Fed. 947, 959, 68 C. C. A. 505, 517. Let the judgments below be *Affirmed.*

Filed December 9, 1914.

(Judgment in Cause No. 4081.)

United States Circuit Court of Appeals,
Eighth Circuit. December Term, 1914.
Wednesday, December 9, 1914.

Fred von Baumbach, Collector of Internal Revenue, Plaintiff in Error,
No. 4081. *vs.*
Sargent Land Company, a corporation.

In Error to the District Court of the United States for the District of Minnesota.

This cause came on to be heard on the transcript of the record from the District Court of the United States for the District of Minnesota, and was argued by counsel.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court, in this cause, be, and the same is hereby, affirmed with costs; and that the Sargent Land Company, a corporation, have and recover against Fred von Baumbach, Collector of Internal Revenue, the sum of

Twenty-six and 25/100 Dollars for its costs herein to be collected in accordance with law.

December 9, 1914.

(Judgment in Cause No. 4082.)

United States Circuit Court of Appeals,
Eighth Circuit. December Term, 1914.
Wednesday, December 9, 1914.

Fred von Baumbach, Collector of Internal Revenue, Plaintiff in Error,
No. 4082. *vs.*
Sutton Land Company, a corporation.

In Error to the District Court of the United States for the District of Minnesota.

This cause came on to be heard on the transcript of the record from the District Court of the United States for the District of Minnesota, and was argued by counsel.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court, in this cause, be, and the same is hereby, affirmed with costs; and that the Sutton Land Company, a corporation, have and recover against Fred von Baumbach, Collector of Internal Revenue, the sum of Twenty-one and no/100 Dollars for its costs herein to be collected in accordance with law.

December 9, 1914.

(Judgment in Cause No. 4083.)

United States Circuit Court of Appeals,
Eighth Circuit. December Term, 1914.
Wednesday, December 9, 1914.

Fred von Baumbach, Collector of Internal Revenue, Plaintiff in Error,
No. 4083. *vs.*
Kearsarge Land Company, a corporation.

In Error to the District Court of the United States for the District of Minnesota.

This cause came on to be heard on the transcript of the record from the District Court of the United States for the District of Minnesota, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court, in this cause, be, and the same is hereby, affirmed with costs; and that the Kearsarge Land Company, a corporation, have and recover against Fred von Baumbach, Collector of Internal Revenue, the sum of Twenty-one and no/100 Dollars for its costs herein to be collected in accordance with law.

(Clerk's Certificate.)

United States Circuit Court of Appeals,
Eighth Circuit.

I, John D. Jordan, Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, do hereby certify that the foregoing contains the transcript of the record from the District Court of the United States for the District of Minnesota as prepared and printed under the rules of the United States Circuit Court of Appeals for the Eighth Circuit, under the supervision of its Clerk, and full, true and complete copies of all the pleadings, record entries and proceedings, including the opinion, had and filed in the United States Circuit Court of Appeals except the full captions, titles and endorsements omitted in pursuance of the rules of the Supreme Court of the United States, in certain causes in said Circuit Court of Appeals wherein Fred von Baumbach, Collector, etc., is Plaintiff in Error and Sargent Land Company, a corporation, is Defendant in Error, No. 4081; wherein Fred von Baumbach, Collector, etc., is Plaintiff in Error and Sutton Land Company, a corporation, is Defendant in Error, No. 4082, and wherein Fred von Baumbach, Collector, etc., is Plaintiff in Error and Kearsarge Land Company, a corporation, is Defendant in Error, No. 4083, as full, true and complete as the originals of the same remain on file and of record in my office.

I do further certify that on the ninth day of February, A. D. 1915, a mandate was issued out of said Circuit Court of Appeals in each of said causes, directed to the Judges of the District Court of the United States for the District of Minnesota.

In Testimony Whereof, I hereunto subscribe my name and affix the seal of the United States Circuit Court of Appeals [SEAL.] for the Eighth Circuit, at office in the City of St. Louis, Missouri, this ninth day of November, A. D. 1915.

(Signed) JOHN D. JORDAN,
Clerk of the United States Circuit Court of Appeals
for the Eighth Circuit.

166 In the Supreme Court of the United States, October Term, 1915.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
v.
SARGENT LAND COMPANY. } No. 707.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
v.
SUTTON LAND COMPANY. } No. 708.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
v.
KEARSARGE LAND COMPANY. } No. 709.

Stipulation as to return to writ of certiorari.

It is hereby stipulated by counsel for the parties to the above-entitled causes that the certified copy of the record now on file in the Supreme Court of the United States shall constitute the return of the clerk of the United States Circuit Court of Appeals for the Eight Circuit to the writs of certiorari granted therein.

JNO. W. DAVIS,
Solicitor General.
JOHN R. VANDERLIP,
Counsel for Respondents.

December 9, 1915.

(Endorsed:) Nos. 707, 708, & 709. In the Supreme Court of the United States. October term, 1915. Fred von Baumbach, collector, &c., v. Sargent Land Company. Fred von Baumbach, collector, &c., v. Sutton Land Company. Fred von Baumbach, collector, &c. v. Kearsarge Land Company. Stipulation as to return to writ of certiorari. Filed Dec. 17, 1915. John D. Jordan, clerk.

167 UNITED STATES OF AMERICA, *ss:*

[SEAL.] *The President of the United States of America to the honorable the judges of the United States Circuit Court of Appeals for the Eighth Circuit, greeting:*

Being informed that there is now pending before you a suit in which Fred von Baumbach, collector of internal revenue, is plaintiff in error, and Sargeant Land Company is defendant in error, No. 4081, which suit was removed into the said Circuit Court of Appeals by virtue of a writ of error to the District Court of the United States for the district of Minnesota, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and removed into the Supreme Court of the United States,
168 do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the Honorable Edward D. White, Chief Justice of the United States, the 8th day of December, in the year of our Lord one thousand nine hundred and fifteen.

JAMES D. MAHER,
Clerk of the Supreme Court of the United States.

Return to writ.

UNITED STATES OF AMERICA, *Eighth Circuit, ss:*

In obedience to the command of the within writ of certiorari and in pursuance of the stipulation of the parties, a full, true, and complete copy of which is hereto attached, I hereby certify that the transcript of record furnished with the application for a writ of certiorari in the case of Fred von Baumbach, collector of internal revenue, plaintiff in error, vs. Sargent Land Company, a corporation, No. 4081, is a full, true, and complete transcript of all the pleadings, proceedings, and record entries in said cause as mentioned in the certificate thereto.

In testimony whereof, I hereunto subscribe my name and affix the seal of the United States Circuit Court of Appeals for the Eighth Circuit, at office in the city of St. Louis, Missouri, this seventeenth day of December, A. D. 1915.

[SEAL.] JOHN

Clerk of the United States Court,
of Appeals for the Eighth Circuit.

Documentary revenue stamp not required.

(Indorsed:) File No. 24990. Supreme Court of the United States, No. 707, October term, 1915. Fred von Baumbach, collector of internal revenue, vs. Sargent Land Company. Writ of certiorari. Office of the clerk, Supreme Court, U. S. Received Dec. 21, 1915. Filed Dec. 17, 1915. John D. Jordan, clerk.

169 (Indorsed:) File No. 24990. Supreme Court U. S., October Term, 1915. Term No. 707. Fred von Baumbach, collector of internal revenue, petitioner, vs. Sargent Land Company. Writ of certirorari and retur .n Filed December 21, 1915.

170 In the Supreme Court of the United States, October Term, 1915.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
v.
SARGENT LAND COMPANY. } No. 707.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
v.
SUTTON LAND COMPANY. } No. 708.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
v.
KEARSARGE LAND COMPANY. } No. 709.

Stipulation as to return to writ of certiorari.

It is hereby stipulated by counsel for the parties to the above-entitled causes that the certified copy of the record now on file in the Supreme Court of the United States shall constitute the return of the clerk of the United States Circuit Court of Appeals for the Eighth Circuit to the writs of certiorari granted therein.

JNO. W. DAVIS,
Solicitor General.
JOHN R. VANDERLIP,
Counsel for Respondents.

December 9, 1915.

(Endorsed:) Nos. 707, 708 & 709. In the Supreme Court of the United States. October Term, 1915. Fred von Baumbach, collector, &c., v. Sargent Land Company. Fred von Baumbach, collector, &c., v. Sutton Land Company. Fred von Baumbach, collector, &c., v. Kearsarge Land Company. Stipulation as to return to writ of certiorari. Filed Dec. 17, 1915. John D. Jordan, clerk.

171 UNITED STATES OF AMERICA, *ss:*

[SEAL.] *The President of the United States of America to the honorable the judges of the United States Circuit Court of Appeals for the Eighth Circuit, greeting:*

Being informed that there is now pending before you a suit in which Fred von Baumbach, collector of internal revenue, is plaintiff in error, and Sutton Land Company is defendant in error, No. 4082, which suit was removed into the said Circuit Court of Appeals by virtue of a writ of error to the District Court of the United States for the District of Minnesota, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and
172 removed into the Supreme Court of the United States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the honorable Edward D. White, Chief Justice of the United States, the 8th day of December, in the year of our Lord one thousand nine hundred and fifteen.

JAMES D. MAHER,
Clerk of the Supreme Court of the United States.

Return to writ.

UNITED STATES OF AMERICA,
Eighth Circuit, ss:

In obedience to the command of the within writ of certiorari, and in pursuance of the stipulation of the parties, a full, true, and complete copy of which is hereto attached, I hereby certify that the transcript of record furnished with the application for a writ of certiorari in the case of Fred von Baumbach, collector of internal revenue, plaintiff in error, vs. Sutton Land Company, a corporation, No. 4082, is a full, true, and complete transcript of all the pleadings, proceedings, and record entries in said cause as mentioned in the certificate thereto.

In testimony whereof I hereunto subscribe my name and affix the seal of the United States Circuit Court of Appeals for the Eighth Circuit at office in the city of St. Louis, Missouri, this seventeenth day of December, A. D. 1915.

[SEAL.]

JOHN D. JORDAN,
Clerk of the United States Circuit Court of Appeals for the Eighth Circuit.

Documentary revenue stamp not required.

(Indorsed:) File No. 24991. Supreme Court of the United States, No. 708, October Term, 1915. Fred von Baumbach, collector of internal revenue, vs. Sutton Land Company. Writ of certiorari. Office of the Clerk, Supreme Court U. S. Received Dec. 21, 1915: Filed Dec. 17, 1915. John D. Jordan, clerk.

173 (Indorsed:) File No. 24991. Supreme Court U. S., October term, 1915. Term No. 708. Fred von Baumbach, collector of internal revenue, petitioner, vs. Sutton Land Company. Writ of certiorari and return. Filed December 21, 1915.

174 In the Supreme Court of the United States. October Term, 1915.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
v.
SARGENT LAND COMPANY. } No. 707.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
v.
SUTTON LAND COMPANY. } No. 708.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
v.
KEARSARGE LAND COMPANY. } No. 709.

Stipulation as to return to writ of certiorari.

It is hereby stipulated by counsel for the parties to the above-entitled causes that the certified copy of the record now on file in the Supreme Court of the United States shall constitute the return of the clerk of the United States Circuit Court of Appeals for the Eighth Circuit to the writs of certiorari granted therein.

JNO. W. DAVIS,
Solicitor General.
JOHN R. VANDERLIP,
Counsel for Respondents.

DECEMBER 9, 1915.

(Endorsed:) Nos. 707, 708 & 709. In the Supreme Court of the United States. October term, 1915. Fred von Baumbach, collector, &c., v. Sargent Land Company. Fred von Baumbach, collector, &c., v. Sutton Land Company. Fred von Baumbach, collector, &c., v. Kearsarge Land Company. Stipulation as to return to writ of certiorari. Filed Dec. 17, 1915. John D. Jordan, clerk.

175 UNITED STATES OF AMERICA, *ss:*

The President of the United States of America to the Honorable the Judges of the United States Circuit Court of Appeals for the Eighth Circuit, greeting:

[SEAL.]

Being informed that there is now pending before you a suit in which Fred von Baumbach, collector of internal revenue, is plaintiff in error and Kearsarge Land Company is defendant in error, No. 4083, which suit was removed into the said Circuit Court of Appeals by virtue of a writ of error to the District Court of the United States for the District of Minnesota, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals
176 and removed into the Supreme Court of the United States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the Honorable Edward D. White, Chief Justice of the United States, the 8th day of December, in the year of our Lord one thousand nine hundred and fifteen.

JAMES D. MAHER,
Clerk of the Supreme Court of the United States.

Return to writ.

UNITED STATES OF AMERICA,
Eighth Circuit, ss:

In obedience to the command of the within writ of certiorari and in pursuance of the stipulation of the parties, a full, true, and complete copy of which is hereto attached, I hereby certify that the

transcript of record furnished with the application for a wri
certiorari in the case of Fred von Baumbach, collector of inte
revenue, plaintiff in error, vs. Kearsarge Land Company, a corp
tion, No. 4083, is a full, true, and complete transcript of all the pl
ings, proceedings, and record entries in said cause as mentione
the certificate thereto.

In testimony whereof, I hereunto subscribe my name and
the seal of the United States Circuit Court of Appeals for
Eighth Circuit, at office in the city of St. Louis, Missouri,
seventeenth day of December, A. D. 1915.

[SEAL.] JOHN D. JORDAN,
Clerk of the United States Circuit
Court of Appeals for the Eighth Circu

Documentary revenue stamp not required.

(Indorsed:) File No. 24992. Supreme Court U. S., Oct
term, 1915. Term No. 709. Fred von Baumbach, collector of
ternal revenue, petitioner, vs. Kearsarge Land Company. Writ
certiorari and return. Filed December 21, 1915.

○

FILED
DEC 4 1916
CLERK

Supreme Court of the United States.

OCTOBER TERM, 1916.

No. 286.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
Petitioner,

vs.

SARGENT LAND COMPANY, A CORPORATION,
Respondent.

No. 287.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
Petitioner,

vs.

SUTTON LAND COMPANY, A CORPORATION,
Respondent.

No. 288.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
Petitioner,

vs.

KEARSARGE LAND COMPANY, A CORPORATION,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth District.

Brief for Respondents.

JOHN R. VAN DERLIP,
Counsel for Respondents,
906 Metropolitan Life Building,
Minneapolis, Minnesota.

BURT F. LUM,
KENNETH TAYLOR,
Associate Counsel.

Review Publishing Company, 225 So. 3rd St., Minneapolis

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Supreme Court of the United States.

OCTOBER TERM, 1916.

No. 286.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE,
Petitioner,

vs.

SARGENT LAND COMPANY, A CORPORATION,
Respondent.

No. 287.

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Petitioner,

vs.

KEARSARGE LAND COMPANY, A CORPORATION,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth District.

Brief for Respondents.

STATEMENT OF FACTS.

(Figures in parentheses refer to pages of the Transcript of Record).

These three cases come up on writs of certiorari directed to the United States Circuit Court of Appeals for the Eighth Cir-

cuit. Each case presents the same precise question as the others, and the three were tried together upon a single record. Judgments were entered in favor of the respondents in the District Court and were affirmed by the Circuit Court of Appeals (pages 40-1, 155-6).

The decision of the District Court is reported in 207 Federal Reporter, 423; that of the Circuit Court of Appeals, in 219 Federal Reporter, 31.

Nature of These Suits.

These suits demand a construction of the Corporation Excise Act of August 5, 1909. The Income Tax Law of October 3, 1913, is not here involved.

The litigation arose over the attempt of the Commissioner of Internal Revenue to exact from the respondents payment of corporation excise taxes, under the Act of August 5th, 1909, for the years 1909, 1910 and 1911, in sums aggregating more than $23,000. The action of the Commissioner was arbitrary, and, as the respondents believe, unauthorized. The respondents advised the Commissioner fully as to their status, and asserted that they were not liable to taxation under the Act, because (a) they were not organized for profit, (b) were not carrying on or doing business in the years in question, and (c) had no net income upon which, as a basis, a lawful tax could be assessed, the pecuniary receipts of the companies representing merely conversion of capital assets into money, and not income.

A prolonged correspondence extending over almost two years, together with an examination of the books and records of the respondents by an accountant appointed by the Commissioner, resulted in an order of the Commissioner in September, 1912, requiring the filing of returns by the respondents for the years 1910 and 1911, which requirement was promptly complied with. Later on, a return for the year 1909 was demanded and

was as promptly furnished. The returns so made did not accord with the Commissioner's views, and he thereupon prepared returns for the respondent companies which he required them to verify and file (which was done by them under protest), and excise taxes for the three years named were assessed against them on the basis of such returns, with a penalty of 50% added thereto for alleged delay in filing returns, although the delay was occasioned by the failure of the Commissioner to arrive at a decision regarding the respondents' taxability, until September, 1912.

Claims in abatement having been denied, the taxes were paid under protest, and an application for refundment was filed and overruled, and thereafter these suits were instituted.

Origin of Respondent Companies.

In 1890, John S. Pillsbury, George A. Pillsbury and Charles A. Pillsbury, doing business under the firm name of John S. Pillsbury & Company, were the owners of many thousand acres of lands in Northern Minnesota which had been acquired for the timber thereon, but from which the timber had been cut and removed many years before. *After the removal of the timber, the lands were valuable only for the mineral deposits if any, which might be found in them* (pages 51, 71; Decision of Court of Appeals, pages 143, 146, 148, 149, 151). In the year named they entered into an arrangement with John M. Longyear and Russell M. Bennett, pursuant to which Messrs. Longyear and Bennett were authorized to explore the lands for iron deposits under an agreement by which they should receive title to one-half of the lands which they might designate as promising to have mineral value, excepting, however, any timber which might be standing thereon, the title to which was to be reserved by the grantors (pages 51, 71; Decision of Court of Appeals, page 144). In 1892, Longyear and Bennett having discovered in the course of their explorations valuable deposits

of iron ore upon portions of these lands, an one-half interest in something over 10,000 acres was conveyed to them under the agreement, and thereafter the lands were owned as follows: John S. Pillsbury, an undivided 1/6; George A. Pillsbury, an undivided 1/6; Charles A. Pillsbury, an undivided 1/6; John M. Longyear, an undivided 1/4; and Russell M. Bennett, an undivided 1/4 (page 45; Decision of Court of Appeals, page 144).

By the year 1901, each of the partners in John S. Pillsbury & Company had died and their respective estates descended, or were devised, to numerous heirs, many of whom were minors of tender age, and in undivided interests as small as 1/108 part of the whole.

The difficulties presented by the situation are obvious (pages 45-7; Decision of District Court, page 114; Decision of Court of Appeals, page 144).

To avoid these difficulties, the three respondent companies were incorporated in February, 1906, but did not meet for organization until July 19th, 1906 (pages 62, 66).

Under the laws of Minnesota, corporations (with certain exceptions unimportant here) are prohibited from owning more than 5,000 acres of land (Gen. Stat. 1894, section 5877; Gen. Stat. 1913, section 6698; Record, page 47). In order to embrace all the lands, three corporations were therefore necessary (page 47).

Purposes of Organization.

The companies were created in order to secure a united, convenient and effectual control of the mineral properties belonging to the Pillsbury heirs and Messrs. Longyear and Bennett; to protect them against further complication by the death or marriage of any of the numerous heirs, by the transfer of some small interest to one "outside of the family" (page 46), or by the possibility of disagreements among them as to the

handling and disposition of the lands, and, especially, to provide a practical mode of partition by converting the properties into money for distribution in proportion to the several interests of the members. It was also an essential condition of the taking by the Van Buren Iron Mining Company of a mining contract (to be presently mentioned) that the contract should be executed by a corporation, because the guardian of a minor was prohibited by statute from making contracts respecting real property for a longer period than 25 years, and the period of the Van Buren contract was indeterminate (pages 46-7, 51, 52, 68-9). A glance at the articles of incorporation (which are identical in each instance, with the exception of the names of the companies and officers) will indicate the peculiar character and purpose of these companies (pages 7-12, 19-23, 31-35). The capitalization of each of the companies was fixed at $108,000 (although the value of the properties owned by each was greatly in excess of that sum), for the sole purpose of accommodating the issuance of capital stock to the smallest fractional interest held by any one of the Pillsbury heirs, and without intending to express the true worth of the capital assets; and $1,000.00 worth of stock, par value, was issued for each 1/108 owned by any of the parties (Decision of Court of Appeals, page 145).

As originally created, the general nature of the business of each of the corporations was declared to be:

> "—the buying, owning, exploring and developing, leasing, improving, selling and dealing in lands, tenements and hereditaments, and the doing of all things incidental to the things above specified." (Article I, page 8).

The stockholders of the respondent companies were desirous only of liquidating the properties conveyed to the corporations, and of converting them into money, in order that each might obtain and control his or her share in severalty (pages 48-9), and subsequently, in December, 1909, the articles of incorporation were, in each instance, amended so that Article I thereof

read, and now reads, as follows:

> "The general purpose of the corporation is to unite in one ownership the undivided, fractional interests of its various stockholders in lands, tenements and hereditaments and to own such property, and, for the convenience of its stockholders, to receive and distribute to them the proceeds of any disposition of such property, at such times, in such amounts, and in such manner as the Board of Directors may determine." (See Answers, pages 3, 15, 26; Evidence, pages 105, 106; Decision of District Court, page 117; Decision of Circuit Court of Appeals, page 145).

It appears, then, that, from the time of this amendment, the respondents *ceased to have power to engage in business*, whether for profit or otherwise (Decision of Court of Appeals, page 155).

Zonne v. Minneapolis Syndicate, 220 U. S. 187.

Unique Provisions of Charter.

The articles of incorporation of each company disclose a careful intent to pursue this declared purpose. By Article VI (identical in each case) a board of ten directors is provided for, and, in case a vacancy shall occur, a special meeting of the stockholders must be called to fill such vacancy. Article X recites the diversified ownership of the property prior to conveyance to the corporations, the division of such owners into two general classes, to-wit: the "Pillsbury heirs" on the one hand, and Messrs. Longyear and Bennett on the other, and the fact that the corporation has been formed by mutual agreement of all said owners of both classes for the more convenient handling, improvement, development and disposition of the properties; and, expressing the desire and intention of all owners that an equal voice in all matters relative to said properties shall be maintained in said two classes, provides:

> "It is hereby established as the perpetual and undeviating rule of this corporation that one-half of the entire Board of Directors of this corporation shall always be nominated by, and elected to represent, each of said two

> classes of former owners so that * * * five directors, and five only, shall be chosen by the stockholders of this corporation from nominees of 'The Pillsbury Heirs,' constituting one class, and five directors, and five only, shall be chosen by such stockholders from nominees of said Bennett and said Longyear, constituting the other class."

It is further provided in Article X that, in case a vacancy shall occur in the Board of Directors, it shall be filled by a nominee of the class by which the director whose retirement caused such vacancy was nominated.

Lest some one of the numerous owners might dispose of an interest in the properties "outside of the family," so also it was deemed desirable to restrict the ownership of the corporate stock. Accordingly, by Article VIII, any sale, assignment, transfer, hypothecation, pledge or other disposition of the capital stock of the corporation is forbidden unless the approval or consent of a majority of the Board of Directors, sitting as a Board, is first obtained.

As a further safeguard, Article IX forbids the sale or disposition of any interest in the real property except upon the affirmative vote of the holders of 75 per centum of the capital stock; and, by Article XI, no alteration, amendment or abrogation of Article X can be made except by a vote of 90 per centum of the outstanding shares of capital stock, nor can any other Article be altered, amended or abrogated except by the vote of 75 per centum of such shares.

Peculiar Nature of Properties Conveyed to the Companies.

During the lifetime of the Messrs. Pillsbury, and long prior to the incorporation of the respondent companies, the right to open mines and to extract, have, and carry away, all of the iron ore in said lands (except certain lands included in the Van Buren Company contract) had been sold to and vested in different mine operators under contracts in the form of Exhibit

15, some of which contracts are still in force (pages 71, 73, 74, 97-8; Decision of Court of Appeals, pages 146, 148). But some of the contracts, by reason of the exhaustion of the ore in the lands to which they related, were surrendered before the year 1909, and became valueless (pages 53, 71-2; Decision of Court of Appeals, page 150).

To complete an arrangement made before the organization of the corporations (pages 50-1, 68-9; Decision of Court of Appeals, pages 144, 145-6, 149), the *Sargent Land Company,* under date of January 2nd, 1907, made a similar contract with the Van Buren Iron Mining Company (Exhibit 16) covering all the remaining land which contained ore (page 59). This is the only sale of mineral made, even nominally, by any of the respondents (pages 51, 75), and it was made more than two years before the tax law was enacted.

The mode thus pursued is the customary and most effective, and substantially the only practicable way of selling iron ore in place and of converting it into money. Contracts in the form of these exhibits are commonly called "mining leases" (pages 95-6; Decision of Court of Appeals, pages 144-5).

After the death of the elder Pillsburys, and up to the incorporation of respondents, the individual owners of the lands did nothing with them except what was necessary to dispose of them and convert them into money for distribution among themselves (Decision of Court of Appeals, page 144).

The lands owned by the several companies had no value except for the minerals therein (pages 51, 71; Decision of Court of Appeals, pages 143, 146, 148, 149, 151); *all of the lands which were within the mineral range had been explored and the mineral contents thereof definitely ascertained* (pages 55, 61-2), *and all of the ore therein had been disposed of prior to the year 1909 under mineral contracts in the form shown by Exhibits 15 and 16* (pages 59, 62). In July, 1906, the various outstanding interests in the lands, including the interests which had

been acquired by Messrs. Longyear and Bennett, were conveyed to the corporations (page 66; Decision of Court of Appeals, page 145). The devolution of title, as recited herein, was admitted by the petitioner (pages 67-8).

It will thus be seen that the actual property rights conveyed by the former individual owners of the lands and acquired, as stated, by the respondent companies, were the rights or claims to receive the payments to be made under the mining contracts (Decision of Court of Appeals, pages 143, 144, 145, 146, 148, 149, 150, 151); *and that the amount of such payments receivable under the contracts was fixed without possibility of increase* (pages 74, 88, 95; Decision of District Court, page 123; Decision of Court of Appeals, *ubi supra*).

General Provisions of Mining Contracts.

All of the contracts covering the properties of the land companies, with the exception of the contract with the Van Buren Iron Mining Company, were in the same general form shown by Exhibit 15 (pages 97-8). As already stated, the contract with the Van Buren Iron Mining Company (which was the only contract executed after the organization of the companies) was in a somewhat different form but embraced substantially the same terms and conditions. This form is shown in Exhibit 16.

> [*To avoid the expense of incorporating these exhibits in the printed record, copies were transmitted to the Circuit Court of Appeals pursuant to stipulations (pages 134-6), and have been sent up to this Court*].

Each of these contracts provided, substantially, that the owners of the property (referred to as *lessors*) demised to the mine operators (designated as *lessees*), *exclusively,* all the lands covered by the respective instruments, for the purpose of exploring for, mining and removing the merchantable iron ore which might be found therein for and during a specified

period (usually 50 years) from the date of the instrument, which period was, in every case, more than sufficient to permit the extraction and shipment of all of the ore contained in the lands (Decision of Court of Appeals, pages 148, 149, 151). The lessees were given the exclusive right to occupy and control the demised premises and to erect all necessary buildings, structures and improvements thereon; the lessors, however, reserved the right to enter for the purpose of observing the operations from time to time and of measuring the amount of ore mined and removed, but in such manner as would not interfere with the work of the lessees. The lessees agreed to pay the lessors the sum (in most cases) of 25c per ton for all merchantable iron ore mined and removed from the premises, and to make such payments monthly for ore mined and shipped during the preceding month. The lessees further agreed to mine and ship a specified quantity of ore in each year and, if, for any reason, the agreed amount should not be mined and shipped, nevertheless to pay the lessors for the minimum amount so specified and to take credit therefor and apply any sums, so paid for ore not actually mined and shipped, upon ore mined and shipped thereafter in excess of such minimum (page 92; Decision of Court of Appeals, page 148).

The lessees were, in addition, to pay all taxes that might be assessed against the property during the continuance in force of the contract, and were to preserve the property free from liens or encumbrances arising through their occupancy or operation.

All ore mined and shipped was to be weighed by the Railway Company transporting the same, and reports of such weights, in the absence of disclosed errors, were to be the basis of settlement between the parties. All operations were to be carried on in accordanc with the requirements of good engineering and in a workmanlike manner and without unnecessary waste.

In case of default by the lessees in the observance of their

contract obligations, the lessors were entitled, at their election and after due notice and opportunity given to remedy the default, to terminate the contracts.

So long as the lessees should fulfill the terms of the mining contracts, the land owners (the respondent companies) could make no disposition of the iron ore, and, regardless of the market value thereof, could receive no different price therefor than the sums specified in the contracts (page 74; Decision of Court of Appeals, page 148); nor, except for the purposes of inspection of the work, could the respondents enter upon or occupy any portion of the lands or exercise any control or authority over the same (page 74).

Course of Procedure by Companies After Organization.

After organization, the corporations engaged in no activities but merely received the moneys paid to them under the various contracts relating to their lands and distributed the same to their shareholders (pages 49, 68-9; Decision of Court of Appeals, pages 144, 146).

It is claimed, however, by the Government, for the purpose of maintaining its right to impose upon them a corporation excise tax, that they engaged in activities with a view to profit, constituting a carrying on or doing business during the years 1909, 1910 and 1911. A statement respecting the activities thus relied upon by the Government is therefore necessary.

1. Sales of Platted Lands.

Before the deaths of the original Pillsbury owners and long before the organization of the corporations in 1906, three tracts, aggregating about 170 acres out of the 10,000 acres conveyed to the respondents, had been platted into town lots (pages 54, 70, 93; Decision of Court of Appeals, page 146); and, prior to the conveyance to the corporation, the exclusive

right to handle and sell the lands so platted had been vested, by contract made by the individual owners, in one Edmund J. Longyear (pages 75, 93; Decision of Court of Appeals, page 146), and the lands were received by the respondent companies subject to such contracts. From time to time since the organization of the companies, Longyear, acting under his said contract, has disposed of certain of the platted lots and paid the purchase price into the corporation holding the title to such lots (page 75; Decision of Court of Appeals, page 146). No lands have ever been platted by the companies (pages 54, 70; Decision of Court of Appeals, page 146), nor has any of the companies sold or disposed of any of the lots except such as have been sold by Longyear under said contracts (page 75).

2. Timber Sales.

Some timber (not claimed by the Pillsburys) had grown up and existed on portions of the 10,000 acres, which, at times of forest fires, was burned over and, as timber injured by fire rapidly deteriorates and becomes worthless, it was thereupon disposed of by the companies in order to save total loss (pages 85, 104-5; Decision of Court of Appeals, page 146).

3. Leasing of Lands.

Certain of the lands belonging to the corporations were squatted upon by miners working in the vicinity, and, in order to compel the speedy vacation of the premises in case the companies might have use for them, the corporation required all such squatters to take, as a condition of their occupancy, a license from the company owning the land occupied permitting such company to give summary notice of termination, and, in case of refusal of the squatter to vacate, to obtain a speedy judgment of eviction (pages 96-7; Decision of Court of Appeals, page 146). A nominal fee of $1.00 per year was charged

for such licenses. By reason of the fact that most of the land in the vicinity was underlaid with iron ore, which was being mined from open pits, so that land adjacent to the village of Hibbing is very scarce, certain tracts belonging to the Land Companies were sought by warehousemen and others for trackage purposes, and, as a favor to them and to the community, the company allowed the occupancy of these lands under similar licenses at nominal rentals aggregating, approximately, $240.00 a year. The companies also allowed the Village of Hibbing to use a tract of land as a site for a schoolhouse, as well as a considerable tract of land for a public park, for which no compensation was asked or received (page 96).

4. Acquisition of Other Land.

The only property which was ever acquired by any of the companies after their organization (other than the property conveyed to them at the outset by the Pillsbury heirs and Messrs. Longyear and Bennett) was a tract of forty acres the purchase of which had been negotiated and concluded before the organization of the companies but the conveyance of which was intentionally not executed and delivered until the organization of the companies, and, in August, 1906, title to the tract was taken in the name of the Sargent Land Company (pages 69, 70; Decision of Court of Appeals, page 146).

5. Inspection of Properties.

In order to be assured that the mining operations carried on under the contracts referred to were properly conducted, and to check reports of quantities of ore mined and removed, the respondents (the right so to do being expressly reserved in the contracts) arranged with the Meriden Iron Company,—a corporation engaged in engineering and in inspection of ore properties for others, in various localities—to provide the neces-

sary supervision and inspection of the work on the respondents' properties, for which services they paid the Meriden Company from month to month as statements therefor were rendered (pages 55, 57, 58, 59, 60-1, 63-4, 99-101).

6. Company Offices.

None of the companies has ever maintained any office, or had any salaried employees, but they have their nominal headquarters in the offices of Mr. Bennett, who is secretary and treasurer of each of the companies, and attends to the receipt and disbursement of their moneys. A certain portion of the salaries paid his office force is charged up to the different companies (page 49).

Respondents Have Never Carried on or Done Business.

Although the amendment of the articles of incorporation was not made until December, 1909, it is undisputed that, unless the facts just recited establish the contrary, none of the corporations engaged in active business of any sort during the years 1909, 1910 and 1911, and that they made no effort to engage in any enterprise for profit. They entered into no contracts; explored and developed no properties; operated no mines; made no investments, and accumulated no surplus (pages 49, 50, 51, 55, 62, 65, 68-9; Decision of Court of Appeals, pages 144, 145, 146, 147, 151, 155); they confined their operations strictly to the accomplishment of the purpose of their organization, namely, the collection of the moneys accruing under the mining contracts, the conversion into money of the properties conveyed to them by their incorporators, and the division of the proceeds, when received, among their stockholders (page 49; Decision of Court of Appeals, page 151).

The contention that respondents were carrying on business is based entirely upon the facts already recited. No testi-

mony or evidence on this subject was offered by the petitioner.

Sources of Respondents' Pecuniary Receipts.

The pecuniary receipts of the respondents during the years 1909, 1910 and 1911, were derived almost entirely from royalties paid under the mining contracts; some small amounts, however, were paid in by Edmund J. Longyear, on account of sales of lots (page 75), under the contracts which he had made during the lives of the Messrs. Pillsbury and subject to which the lands were taken over by the corporations (page 93), and some insignificant sums also accrued from the sales of timber which had been burned over and had to be disposed of in order to save a total loss, as already mentioned.

The amounts thus received, as observed by *Judge Sanborn* (pages 143, 147), were so small and insignificant as to be negligible; and the transactions out of which they were derived "were incidental to and a part of the duties of these corporations, as owners of the claims for the royalties on the ores and "of the lands, *to care for their property as owners*, and to convert it into money and to distribute the money to their stockholders" (page 146).

The petitioner and his counsel adopted the same view at the time of the trial, and in the Court of Appeals, as is demonstrated by the requests for findings and declarations of law filed at the close of the trial (page 113). No claim is based upon any receipts whatever, except receipts from royalties paid under the mining contracts.

Disposition of Corporate Receipts.

Whenever any moneys were received by the respective companies they were at once distributed by the directors to the various stockholders in pursuance of the purposes of organiza-

tion. Distributions were usually made at monthly meetings of the directors, although, occasionally, distributions were made only quarterly (pages 49, 69, 84). The custom and mode of procedure, as recorded on the books of the corporations is shown by the following excerpt from the Secretary's minute book:

> "The treasurer then presented his report in detail for the month [or months] of ..... showing total receipts, including balance on hand [at date of last report] of $.....; disbursements of $.....; leaving in the hands of the treasurer $..... Mr..... moved that a dividend of $..... per share, aggregating $....., be declared, payable immediately. The motion was duly carried, leaving in the hands of the treasurer $....." (page 97).

All of the receipts reported by the treasurer and referred to in such minutes of meetings, represented money paid into the treasury from the liquidation of the companies' assets—and nothing else. These distributions were customarily referred to as "dividends," although they embraced nothing but proceeds of sales of property (pages 69, 84, 94-5, 97; decision of Court of Appeals, page 146).

Arbitrary Assessments Made by Commissioner of Internal Revenue.

The income returns filed by the Companies under the Act of August 5th, 1909, upon requirement of the Commissioner, and which were made up by the said accountant, Mr. Schouler, representing the Treasury Department, were in form as follows (pages 107-8):

SUTTON LAND COMPANY.

1909	
Gross Income	$25,740.00
Deductions for expenses and taxes	1,948.15
Net Income	$23,791.85
Specific Deduction	5,000.00
Taxable Income	$18,791.85
Amount of Taxes Assessed	187.92
1910	
Gross Income	$24,820.00
Deductions for expenses and taxes	2,285.83
Net Income	$22,534.17
Specific Deduction	5,000.00
Taxable Income	$17,534.17
Amount of Taxes Assessed	175.34
1911	
Gross Income	$24,750.00
Deductions for expenses and taxes	2,107.50
Net Income	$22,642.50
Specific Deduction	5,000.00
Taxable Income	$17,642.50
Amount of Taxes Assessed	176.43

By a similar process of calculation the "taxable incomes" of the Kearsarge Land Company and Sargent Land Companies were arrived at by the accountant.

The "gross income" of the respective companies thus shown by Mr. Schouler represents the *entire receipts* of the companies from all sources (page 108).

While expenses and taxes were subtracted from these gross receipts, no deduction whatever was made on account of the depletion of the ore deposits on the respondents' lands resulting in a diminution of the amounts payable under the mining contracts (in which the entire substantial value of the corpor-

ate property consisted), or the extinction of other assets representing invested capital through the conveyance of lots sold, or the sale and removal of the burned timber.

It appears from the brief cross examination of the witness, *Schouler,* that he intentionally included as gross income the *gross receipts* of the companies and, after deducting the ordinary expenses, returned the balance as *net income,* from which he subtracted the statutory exemption of $5,000.00 and returned the remainder as taxable income. The witness announced it to be a fundamental principle of the Department that no claim for depreciation, diminution or depletion will be accepted unless it be evidenced by proper book entries, in reduction of the book value of the assets (pages 110, 111). *Judge Willard,* in the District Court, stated that that was a question of law to be decided by the Court and added, "—but I do not see that the not keeping of a depreciation account is at all material" (page 112).

The only difference between the returns made by the Department's accountant and the returns originally filed by the companies was in the deduction, made by the companies in their returns, for diminution or depletion of assets, which was disallowed by the Department for the reason stated by the witness (pages 110, 111).

Amounts Sought to be Recovered.

Payment of the taxes assessed, determined as above stated, was exacted by the Commissioner of Internal Revenue from the respective companies under threats of distraint and sale of their property, and was made by the companies under protest, and these actions were thereafter instituted to recover the sums so exacted, aggregating, as shown by the judgments entered for the respondents (pages 40-1), $23,321.25, upon the grounds following:

1. That the respondents were not corporations falling within the purview of the Act of August 5th, 1905, because they were not organized for profit.

2. That the respondents were not taxable under said Act, because during the years mentioned they were not carrying on or doing business.

3. That the moneys received by the respondents under the mining contracts referred to, and from the disposition of lots and timber, were not "income" within the meaning of the Act, but constituted a mere conversion of capital assets into money, without gain or profit therefrom.

4. That, if such receipts were "gross income," in whole or in part, the respondents were entitled to subtract therefrom, in order to arrive at "net income," the capital value of their properties so converted, as a deduction contemplated and permitted by the Act.

Decision in District Court, 207 Fed. 423.

The learned District Judge announced that in his opinion the respondents were corporations organized for profit (page 116), and engaged in carrying on or doing business during the years in question (pages 114-116); but he held that the receipts of the companies in said years, upon the basis of which the taxes were assessed, were in fact the *avails of the conversion into money of portions of their capital investments*, and nothing else, and were not income rendering the companies taxable under the law (page 118 *et sequitur*).

Decision of Circuit Court of Appeals, 219 Fed. 31.

The causes having been removed by the petitioner, by writs of error, to the United States Circuit Court of Appeals for the

Eighth Circuit, the judgments of the District Court were there affirmed. In so affirming them, the Court of Appeals held:

1. *That the companies were not and never have been mining companies; have never operated any mines in any way,* and are, and always have been, mere owners of the rights to collect from the lessees the fixed amount per ton of ore mined by the lessees, under mining leases of lands whose only substantial value was the value of the ore therein (page 144).

2. That the mining contracts had been made by the individual owners prior to 1907, and, if there were any gain, profit or income from the making of the contracts, that gain or income accrued before the Tax Act took effect, and the corporations are exempt from taxation on account of it (page 148).

3. That the property acquired by the corporations had no substantial value other than *the rights to collect the royalties payable under the mining contracts,* and that when the Act took effect on January 1st, 1909, and for years before that date, the corporations were the owners of the claims and rights to collect and receive the amounts which the lessees had covenanted to pay for the ore in the lands; that these things were their absolute property on January 1st, 1909; that the lands had no value to the companies in excess of the sums so covenanted to be paid by the lessees, and that none of the amounts received by the companies after January, 1909, was income, gain or profit, but was merely a different form of the respondents' property and capital (pages 148-9).

4. That a mining lease whereby the lessee is granted the absolute and exclusive right to dig for, remove and have the mineral in the land, during a term sufficiently long to enable him to remove it, is in reality a sale of the ore, and the royalties received are, in fact, the purchase price of it (page 149).

5. That, in the application of the Tax Act, the actual facts

of each individual case and their real consequences must be given effect, regardless of misleading names and forms (page 149).

6. That the sole purpose of the organization of the companies was, to collect, by means of them, the value of the rights or claims to the money accruing under the mining contracts, covering the lands conveyed to the companies, and to convert the property into money and distribute it among the grantors to the corporations (pages 150-1).

7. That the moneys received by the corporations, respectively, in the years 1909, 1910 and 1911, under the mining leases, were neither gross income nor net income, and the companies are not taxable on account of them (page 151).

8. That, if there were error in the conclusion that the receipts of the companies in the years named were not a part of their gross income, then the companies would be entitled to a "reasonable allowance for depreciation of their property" by the reduction of the value of their capital assets (represented by the rights to collect under the outstanding contracts) by the amounts of the payments received; that such payments reduced and depreciated the value of such capital assets, by the amounts paid, so that there would be no net income from them on account of which an excise tax could be lawfully exacted (page 154).

9. That the companies have not engaged in mining, trading *or any other business*, but have strictly confined their operations to the accomplishment of the purpose of their organization (pages 151-2); that corporations which are the owners of property not used in business, that engage in no trading, mining or other line of business for gain, but confine their activities to acts necessary or incidental to the protection of their property, and to the conversion of it into money, are not "do-

ing business" within the meaning of the Corporation Tax Act (page 155).

10. That the respondent companies not only so confined their operations, but, by the amendment of their articles of incorporation in the year 1909, disabled themselves from conducting any other operations, or doing any business, within the strict interpretation of the Tax Act and, therefore, were not taxable under that Act (page 155).

Petitioner's Assignments of Error.

In his statement of the facts of the case, *Judge Sanborn* said:

> "The errors assigned are: That the Court should have found and held that the *royalties* received by the companies during the years 1909, 1910 and 1911, constituted *gross income* of the companies during those years, and that the Commissioner was authorized to collect 1% thereof, without any deduction for the depreciation of the property or capital by the collection of these royalties or the conversion of parts of their capital into money and the distribution of the proceeds to the stockholders of the companies" (page 144).

At the close of the trial in the District Court, *Judge Willard,* speaking to the United States Attorney representing the petitioner (page 124), said:

> "I think, Mr. Houpt, that you should make some requests for declarations of law.
>
> *Mr. Houpt*: I would rather except to the ruling of the Court holding that *the receipt of royalties, as shown in this case, does not constitute gross income.*
>
> *The Court*: Note an exception."

Subsequently, however, the petitioner filed three requests for findings and declarations of law, appearing on page 113 of the Transcript, which were overruled and denied.

Five assignments of error were subsequently filed by petition-

er. The first three assignments of error (page 125), are to the effect that the Court erred in refusing to hold and declare the law to be as stated in the three requests respectively. The fourth assignment is that the Court erred in holding and declaring that *royalties* received by the respondents did not constitute "*gross income*" within the meaning and intent of the Act of August 5, 1909. The remaining assignment is that the Court erred in ordering and directing judgment for the respondents.

Reverting to the requests, we find that the Court was asked to declare as matters of law:

> "I. That the *royalties* paid to and received by the defendants in error [respondents here], under and pursuant to the several mining leases referred to in the evidence *constitute and are gross income* within the spirit and meaning of the corporation tax law approved August 5, 1909.
>
> 2. That the Commissioner of Internal Revenue was authorized by said Act of August 5th to assess against the defendants in error the tax mentioned in the complaints herein *upon the royalties paid to the defendants in error* for the years 1909, 1910 and 1911.
>
> 3. That plaintiff in error [petitioner here], is entitled to judgment for the taxes collected under and pursuant to the assessment made by the Commissioner of Internal Revenue, being the same taxes to recover which these actions were instituted."

It will not be controverted that an assignment of error, in order to be effectual as the foundation for a reversal of a judgment, must specify a single error and one which can be sustained as assigned.

It is palpable that the second and third requests for findings and declarations of law are open to the objection that the Court could not possibly have declared the law to be as therein requested; and the assignments of error based on the court's refusal to grant the requests are, therefore, equally futile.

The second assignment is untenable on its face, because, *first,*

"for to do this would be to attribute a different meaning to the "term 'value of the ore in place' than the parties have put upon "it, and to instruct the Circuit Court of Appeals respecting a "question about which instruction has not been requested, and "concerning which it does not even appear that any issue is "depending before that Court."

The effect of this decision is to sustain our contention that questions presented by assignments of error are to be answered *in accordance with those assignments and the requests severally referred to therein.*

The assignments of error in this case present a single theory for the consideration of the Court. They call upon the Court to state—*and to state nothing else, for they all depend upon one proposition*—that *all royalty receipts* of the respondents constitute, and are, *gross income.*

The Various Questions Presented by the Record.

The statement of facts preceding shows that these cases directly present four questions for consideration. These are:

> "1. Are the respondents corporations organized for profit?
>
> 2. Were the respondents carrying on or doing business during the years 1909, 1910 and 1911?
>
> 3. Were moneys received by the respondents during those years in payment for iron ore, under the contracts covering their mineral lands, *gross income*, or did they represent, in whole or in part, the conversion of the investment of the corporations from ore into money?
>
> 4. If such moneys were gross income, are the respondents entitled to make any deduction therefrom on account of the depletion of their capital investment?"

These questions are not complex or technical. If they did not affect internal revenue receipts, it is fair to assert that there would be no controversy regarding the correctness of the conclusions announced in the decision filed in the Circuit

Court of Appeals. The questions, nevertheless, are of large importance and it is highly desirable that a definitive determination of such of them as may properly be passed upon in these suits, should be obtained; for this reason the application of the petitioner for the writs of certiorari, by virtue of which the cases are now before this Court, met with the hearty concurrence of the respondents, and no objections to the granting of the applications were interposed.

The questions are practical and concrete. Although they arise under the Act of August 5, 1909, relating to an excise tax upon corporations, which was substantially repealed by the Income Tax Law, of October 3, 1913, they are still live and will continue to be so for some years to come. The Department of Justice is just now instituting hundreds of suits to enforce the payment of taxes claimed under the provisions of the Act of 1909, as those provisions are construed—or misconstrued—by the Department, and an authoritative interpretation of the Act will be of general advantage.

We shall take up these questions in the order in which they are above stated. If either the first or the second question be answered in the negative, the judgment before the Court must be affirmed; if both be answered in the affirmative, then the Court will be called upon to examine and determine the remaining questions and to consider those parts of this brief relating thereto.

ARGUMENT.

POINT I.

The Respondents Were Not Corporations Organized for Profit.

The language of the Act of 1909, in so far as it is of interest at this juncture, is as follows:

> "Every corporation, joint stock company, or association, (a) organized for profit, and (b) having a capital stock represented by shares, * * * (c) now or hereafter organized under the laws of the United States or of any State or Territory of the United States, * * * shall be subject to pay annually a special excise tax (d), with respect to the carrying on or doing business by such corporation, * * * equivalent to one per centum upon the entire net income over and above $5,000 received by it from all sources during such year, exclusive of amounts received by it as dividends upon stock of other corporations * * * subject to the tax hereby imposed; *provided*, however, that nothing in this section contained shall apply to labor, agricultural or horticultural organizations; or to fraternal beneficiary societies, orders or associations operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders, or associations and dependents of such members; nor to domestic building and loan associations, organized and operated exclusively for the mutual benefit of their members; nor to any corporation or association organized and operated exclusively for religious, charitable, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.
>
> Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation * * * received within the year from all sources, (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; (second), all losses actually sustained

within the year and not compensated by insurance, or otherwise, *including a reasonable allowance for depreciation of property, if any.* * * *"

We hold these truths to be self-evident:

1. That corporations which were *not organized for profit* (whether doing business or not), were not subject to taxation under the law of 1909.

2. That corporations which *were* organized for profit were not taxable thereunder, *unless they carried on or did business during the year for which the tax was imposed.*

Therefore, unless both of the first two questions heretofore stated, can be answered in the affirmative, the third and fourth questions will not demand consideration by this Court.

As concerns the corporations which it was designed to embrace, the provisions of the Act of 1909 above quoted are not obscure. They apply to the corporations coming within the expressed conditions, and to those only. What are those conditions? They are, *first,* that a taxable corporation shall be one organized for profit; *second,* that it shall have a capital stock represented by shares; *third,* that it shall be organized under the laws of the United States, or of any state or territory, and, *fourth,* that it shall be engaged in carrying on or doing business.

Anderson v. Morris & Essex R. R. Co., 216 Fed., 83.
Lewellyn v. Pittsburgh, etc. Ry. Co., 222 Fed., 177.
Flint v. Stone-Tracy Co., 220 U. S., 107, 145, 150, 152.
Elliot v. Freeman, 220 U. S., 178.

The second and third conditions exist in the case of the respondents; the first and fourth have never existed as respects them.

The only reasonable interpretation of which the language of the Act is susceptible is, that a corporation, to be liable to

the tax, *must be carrying on or doing business for the purpose of profit,* because only by doing business of some character can a corporation make profits; and this compels these conclusions: (1) a corporation, even if organized for profit, is not taxable *if it be not carrying on or doing business;* (2) the converse of that proposition, namely, that a corporation which is carrying on or doing business is not taxable *if its activities be not directed to the making of gain;* in other words, if it be not organized for profit. The Act can only be construed as meaning that a corporation, in order to be subject to taxation thereunder, must be *organized to make profit from the carrying on or doing of business.*

In *Lewellyn v. Pittsburgh, B. & L. E. Railway Company,* 222 Fed., 177, decided by the Circuit Court of Appeals for the Third Circuit, it appeared that the Railway Company had leased its railroad, rolling stock and equipment for a long term of years and had surrendered the entire possession, operation and control thereof to its lessee, who paid the rentals directly to the various stockholders of the corporation. Having been subsequently assessed for a corporation excise tax which it paid, under protest that it was not engaged in business during the taxing period and was therefore exempt, it brought suit against the collector to recover the amount so paid. Touching the construction above urged of the Act of 1909, the Court said:

> "The plaintiff corporations were organized for profit under the laws of the state, and their capital was represented by shares, and in these particulars and to this extent at least, they were within the statute. Being organized for profit, *the statute contemplates profits to be earned and income derived from 'carrying on or doing business,'* not for the purpose of taxing their profits or income, but, first, to determine whether the corporation is within the class intended to be taxed, and, second, in order to have a means by which the tax may be calculated. * * * Now, while we make no point of the fact that in this case dividends on stock and interest on bonds were paid by the lessee company directly to the stockholders and bondholders of the plaintiff corporations, and not by the corporations

themselves, nevertheless the income so received *was not derived from railroads operated by them, but was the consideration paid for the right to exclusively possess, manage and operate the leased railroads by the lessee company. The plaintiff railroad corporations received no income from railroads operated by themselves, and expended none in the operation of railroads or for any other purpose.* Receiving no income and disbursing none, there was, of course, no gross income from which to determine net income and no means to measure an excise tax as provided by the statute. Therefore, in being without income *from operating their railroads,* the lessor railroad corporations, to this extent at least, were outside of the scope of the statute" (pages 183-4).

See also *Smith v. Anderson, L. R.,* 15 Ch. Div., 247.

Judge Willard, deciding the cases at bar in the District Court, was of the opinion that the words in the Act "organized for profit" were used to distinguish between *charitable corporations* and all others; and that any corporation organized by private persons for their own advantage and interest, and not for social, charitable, or beneficent purposes, is organized for profit.

We find it impossible to concur in this opinion.

If the Congress had really meant to impose the excise tax upon all corporations except those organized for social, charitable or benevolent purposes, it would undoubtedly have so stated, instead of resorting to the purposeful indirection and ambiguity of which such a construction of its language convicts it. And this is conclusively supported by the subsequent express exemption of just such corporations in the *proviso* at the end of the same paragraph.

The further suggestion, that any corporation organized by private persons for their own advantage or interest is organized for profit, seems likewise untenable. Such an interpretation of the wording of the law is not only extreme, but is opposed to the common and usual acceptation of the words. It would render the requirement specified by the Congress, as a precedent

condition of taxability, utterly nugatory, and would leave the Act as if it had prescribed that every corporation having a capital stock represented by shares shall be subject to the special excise tax with respect to the carrying on or doing business by such corporation; *provided*, however, that nothing in this act shall apply to labor, charitable and other corporations or associations as specified. For it is not sensibly conceivable that any persons would organize a corporation, unless it would be of some advantage to them. But "advantage" is not the word employed in the Act, the word is "profit," and that word must be construed in its general acceptation as intending gain or increase realized from business transactions.

Gray v. Darlington, 82 U. S., 63.

On the other hand, *Judge Sanborn*, delivering the opinion of the Circuit Court of Appeals, said (pages 150-1), after describing the peculiar nature of the respondent companies:

> "The proof is plenary and uncontroverted that the *sole purpose* of the owners of the claims for the royalties and purchase price of the ores and of the lands in organizing the corporations and making them the owners thereof, was to collect, by means of them, these claims, converting the property into money and distributing it among the grantors to the corporations; that this was the sole purpose of the stockholders of the corporations and their directors and officers in receiving the ownership of the property, and that the corporations have confined their operations to so converting into money and distributing the proceeds of this property. * * * Those collections were simply another form of the property of the corporations and of the stockholders substituted for the parts of the claims paid."

Again, at the bottom of page 151, *Judge Sanborn* said, with reference to the nature of the respondent companies:

> "The sole purpose of the conveyance and of their organization was to enable them to collect these claims, convert the property conveyed to them into money, and to divide the proceeds among their stockholders, and the corporations have not engaged in mining, trading or any other business, but have strictly confined their operations

to the accomplishment of that purpose."

Manifestly the term "profit" is distinct from "income," and there can be no just argument for construing the phrase "organized for profit" to mean "owning property"; nor can it be given a definition so as to embrace, in the category of corporations intended to be reached by the Act, those which, though passive, are receiving incomes from invested property but not from "carrying on or doing business."

Zonne v. Minneapolis Syndicate, 220 U. S., 187.
McCoach v. Minehill Company, 228 U. S., 295.
Flint v. Stone-Tracy Co., 220 U. S., 149, 152.

In the apt phrase of *Chief Justice Fuller* in the *Pollock Case*, 158 U. S., 625-6, property is but a fiction without the beneficial use of it; and the receipt of interest, rents or similar income therefrom is simply a concomitant of ownership.

To be "organized for profit" contemplates a definite purpose on the part of the incorporators that the aim of the company shall be to gain profit for its shareholders; and the words of the Act "corporation organized for profit" connote one formed for the "maintenance and operation" of a commercial or other business which will result in gain, and will involve the incurring of rentals, salaries, obligations and other "ordinary and necessary expenses" of an active business.

A corporation, the design of which precludes its engaging in enterprises productive of gain or profit, or of subjecting itself to the chance of incurring losses or the ordinary and necessary expenses incidental to carrying on or doing business, cannot be deemed to fall within the purview of the Act.

The Act of 1909 differed from the various Income Tax Laws which have been enacted in the United States in that it repudiated any intention of taxing *incomes*, but confined its operation wholly to embracing an excise tax with respect to carrying on or doing business by corporations organized for profit.

If the words "organized for profit" be ignored, the Act would apply to every corporation carrying on or doing business, which, concededly, it does not. The phrase cannot be disregarded any more than can be the accompanying clauses "having a capital stock represented by shares," or "carrying on or doing business." And just as it has been distinctly declared by this Court that corporations or associations which are not organized under the laws of the United States or of any State or Territory of the United States (*Eliot v. Freeman*, 220 U. S., 178, 185), or, which, however organized, are not carrying on or doing business (*Flint v. Stone-Tracy Co.*, 220 U. S. 107, 152), are exempt from taxation under the Act of 1909, so it is obvious that corporations which are not organized for profit are similarly exempt.

See in this connection the language of *Lord Justice Cotton* in *Smith v. Anderson*, quoted upon page 85 *post*.

In *Bennett v. Austin*, 81 N. Y., 308, 319, *Judge Miller*, delivering the opinion of the Court of Appeals, distinguished between rents and profits, saying:

> "The *rent* of lands or buildings is such a sum as may be paid and realized from their occupation by tenants, and is fixed and certain, while *profits* are the result of trade which is fluctuating and uncertain and dependent upon skill, care, and the nature and amount of business transacted."

So, in *People v. Board of Supervisors*, 4 Hill, 20, *Bronson*, Judge, stated:

> "It is undoubtedly true that 'profits' and 'income' are sometimes used as synonymous terms, but strictly speaking 'income' means that which comes in or is received *from any business or investment of capital*, without reference to the outgoing expenditures; while 'profits' generally means the *gain* which is made *upon any business or investment* when both receipts and payments are taken into account."

The necessary deduction from these definitions is that Congress specifically intended to embrace within the scope of the Act of 1909 only those corporations which are carrying on some business activity, or are employing their money and property in active commercial or financial enterprises pursued as a regular occupation, for the purposes of making gain above the costs, charges and expenses of so doing,—that is to say, "organized for profit."

The sole purpose of the respondents' organization was to enable the liquidation of the assets contributed, in undivided portions, by the owners, with a view to the partition of the whole and to enable them to realize the money equivalent of their respective contributions, but with no view to dealing, speculating, trading, or gain.

During the period from the creation of the corporations down to the enactment of the law, no business of any sort was attempted, and, immediately after such enactment, the articles of incorporation were so amended as to deprive the corporations of the power to do business which, while nominally possessed before, had never been exercised. But neither under the original articles nor the amended articles was there any intention of carrying on business for profit. The assets of the corporations consisted in lands valuable only for their mineral content,—except the small tracts which had been platted by the original proprietors and placed in the exclusive control of E. J. Longyear as sales agent, under contracts which attached to the premises in the hands of the respondents and which they were without power to terminate.

Of the mineral lands, all had been explored and the mineral deposits had been ascertained and delimited and disposed of, by contracts for terms of fifty years, or over, long before the Act of 1909 was ever conceived. *As a consequence, the amounts receivable by the defendants were fixed unchangeably, without the possibility of increase, in the way of profit or gain, by any*

future fluctuations of market prices or changes in property values.

All of these contracts were executed and in force before the incorporation of the defendants, except the one shown by Exhibit 16, which was made, in fact, before the incorporation, although not executed until January 2, 1907, the delay in execution being due to the circumstances that it could not be made at all unless and until the individual owners should incorporate in order to permit the making of a valid contract extending over the required period (pages 46-7, 69). All minerals having been disposed of under contract by January 2, 1907, at agreed and unchangeable prices, the capital assets of the companies were of the same value on January 1, 1909,—as of which date the excise law became effective—as on December 31st, 1912, the latest date involved in these actions, except to the extent to which the values had been reduced by payments made on the contracts meanwhile. There was manifestly, then, no opportunity for profit, even if it had been in the thought of the incorporators. That there was no such thought is sufficiently evident.

It follows that the judgments entered in these actions are right and must be affirmed. Whether doing business, or not, whether receiving net income, or not, whether otherwise entitled to deduction therefrom by way of depreciation, or not, the defendants are not subject to the special excise tax imposed by the Act of 1909, *because they are not corporations organized for profit, and, therefore, are outside the scope of the law.*

POINT II.

The Respondents Were Not Carrying on or Doing Business During the Years 1909, 1910 and 1911.

The undisputed facts disclose that, regardless of the nature of their articles of incorporation, the respondents, during the years in question, engaged in no substantial activity other than the receipt of moneys payable to them under the outstanding mining contracts and the distribution of such moneys to their stockholders.

The insignificant receipts of $240.00 per year from rentals (exacted in most cases for the purpose of protecting the respondents in the control and power of possession of their lands), of small sums derived from sales of burned timber, and of the proceeds of sale of a few platted lots, do not, as the Court of Appeals well recognized, evidence the "engaging in business" demanded as a prerequisite of taxability. Each and every of these acts was merely incidental to the ownership and protection of property, and each was directly in line with the purpose of the corporate members to accomplish the partition of the assets which they held under joint control. It is submitted that such transactions do not constitute a carrying on or doing of business within the meaning of the Act of 1909.

Whatever interpretation may be put upon the tax sought to be imposed by that Act, it is palpable that none is attempted to be laid except "with respect to carrying on or doing business," for it was only by reason of such limitation that the constitutionality of the law was sustained.

Flint v. Stone-Tracy Co., 220 U. S., 107.

Thus, at page 145:

> "It is therefore apparent, giving all the words of the statute effect, that the tax is imposed not upon the franchises of the corporation *irrespective of their use in business*, nor upon the property of the corporation, *but upon*

the doing of corporate or insurance business, and with respect to the carrying on thereof, in a sum equivalent to one per centum upon the entire net income over and above $5,000.00 received from all sources during the year; that is, when imposed in this manner, it is a tax upon the doing of business with the advantages which inhere in the peculiarities of corporate or joint stock organizations of the character described. As the latter organizations share many benefits of corporate organization, it may be described generally as *a tax upon the doing of business in a corporate capacity*".

Again, at page 150:

"The Act now under consideration does not impose direct taxation upon property solely because of its ownership. * * * The *Pollock Case* construed the tax there levied as direct, because of its ownership. In the present case *the tax is not payable unless there be a carrying on or doing of business in the designated capacity, and this is made the occasion for the tax,* measured by the standard prescribed. The difference between the Acts is not merely nominal, but rests upon *substantial differences between the mere ownership of property and the actual doing of business in a certain way.*"

And at page 151:

"The tax under consideration, as we have construed the statute, may be described as an excise upon the particular privilege of *doing business in a corporate capacity, i. e.,* with the advantages which arise from corporate or *quasi corporate* organization. * * * As was said in the *Thomas Case,* 192 U. S. 363, the requirement to pay such taxes involves the *exercise* of privileges, and the element of absolute and unavoidable payment is lacking. *If business is not done in the manner described in the statute, no tax is payable.*"

It is asserted by the petitioner that the cases at bar fall directly within *Mitchell v. Clark Iron Company*, 220 U. S., 107, 170, and the complaint in the case is quoted from to show the similarity of their facts.

That case was one of the many embraced in the decision of *Flint v. Stone-Tracy Company*, 220 U. S., 107, the *Clark Iron Company Case* being briefly mentioned at pages 170 and 171.

While the petitioner's quotation from the bill of complaint is, of course, correct, the important point to note is, that *the question whether the Clark Iron Company was "doing business" within the meaning of the statute, was not an issue in the case.* The action was an attack upon the Act of August 5th, 1909, solely upon the ground of its unconstitutionality, as is evidenced by the averments of the complaint, taken as a whole, by the brief of the Company's counsel, and, specifically by the single assignment of error filed in the cause, which is found upon page 34 of the Transcript, and reads as follows:

> "That the decree in the above entitled cause is erroneous and against the just rights of said plaintiff for the following reason: That the demurrer of the defendants should have been overruled *for the reason that the statute referred to in the bill of complaint is unconstitutional and void for the reasons therein set forth.*"

In disposing of the *Clark Iron Company Case,* this Court made only the following reference to it:

> "The Clark Iron Company was organized under the laws of Minnesota, owns and leases ore lands for the purpose of carrying on mining operations, and receives a royalty, depending upon the quantity of ore mined" (page 170).

And, at page 171:

> "We think it is clear that corporations organized for the purpose of doing business, *and actually engaged in such activities* as * * * leasing ore lands and collecting royalties * * * are engaged in business within the meaning of this statute * * *."

It is perfectly apparent that this Court assumed that the Clark Iron Company was continuing, after the passage and approval of the Act, to make leases from time to time, an activity, which, if it existed, may be conceded to be doing business within the statute. That the Court so assumed, is abundantly shown by other cases decided at the same and later dates,

which are in direct conflict with the holding which the Government would now impute to the *Clark Iron Company Case.*

Authorities Relied Upon by Respondents.

The court did not have in mind, and did not pass upon, any question as to what constituted "doing business."

The respondents submit that their exemption from liability to pay a corporate excise tax, upon the ground that they are not doing business, is demonstrated by the reasoning of many courts in the following cases:

Zonne v. Minneapolis Syndicate, 220 U. S., 187;
McCoach v. Minehill Co., 228 U. S., 295;
United States v. Whitridge, 231 U. S., 144;
United States v. Emery, Bird, Thayer Realty Co., 237 U. S., 28;
Minehill Co. v. McCoach, 192 Fed., 670;
Emery, Bird, Thayer Realty Co. v. United States, 198 Fed., 242;
Abrast Realty Co. v. Maxwell, 206 Fed., 333;
United States v. Nipissing Mines Co., 206 Fed., 431;
Wilkes-Barre Traction Co. v. Davis, 214 Fed., 511;
Anderson v. Morris & Essex R. R. Co., 216 Fed., 83;
Maxwell v. Abrast Realty Co., 218 Fed., 457;
N. Y. Central Co. v. Gill, 219 Fed., 184;
Public Service Ry. Co. v. Herold, 219 Fed., 301;
Lewellyn v. Pittsburgh Ry. Co., 222 Fed., 177;
Miller v. Snake River Co., 223 Fed., 946;
Traction Companies v. Collector, 223 Fed., 984;
Philadelphia Traction Co. v. McCoach, 224 Fed., 800;
Cambria Steel Co. v. McCoach, 225 Fed., 278;
Bryant & May v. Scott, 226 Fed., 875;
Public Service Electric Co. v. Herold, 227 Fed., 486;
Public Service Gas Co. v. Herold, 227 Fed., 496;
Public Service Ry. Co. v. Herold, 227 Fed., 500;
Waterbury Gaslight Co. v. Walsh, 228 Fed., 54;
State Line Co. v. Davis, 228 Fed., 246;
Public Service Ry. Co. v. Herold, 229 Fed., 902;
McCoach v. Continental, etc., Ry. Co., 233 Fed., 976;
People v. Sohmer, 112 N. E. Rep. (N. Y.), 181.
New York M. & N. Transportation Co. v. Anderson, 234 Fed., 590.

In all of the cases above cited it was held, contrary to the insistence of the Government, that the respective corporations were not engaged in carrying on or doing business within the meaning of the Act of 1909. In many of the cases, the facts approximated very closely those appearing here; in many of them the activities of the corporations involved were much greater than were the activities of the respondents; in all of them the corporations held annual meetings for the election of directors, had meetings of the directors for the election of officers and declaration of dividends, and performed all other acts necessary to maintain their corporate organizations and to protect the corporate properties.

A rough classification of the acts performed by the corporations in the cases cited, and claimed to constitute a doing of business, is as follows:

1. Maintaining corporate organization, collecting rents and distributing the same to stockholders:

Zonne v. Minneapolis Syndicate, 220 U. S., 187;
United States v. Emery, Bird, Thayer Realty Co., 237 U. S., 28;
Abrast Realty Co. v. Maxwell, 206 Fed., 333;
Wilkes-Barre Traction Co. v. Davis, 214 Fed., 511;
Anderson v. M. & E. R. R. Co., 216 Fed., 83;
Maxwell v. Abrast Realty Co., 218 Fed., 457;
Public Service Ry. Co. v. Herold, 219 Fed., 301;
Traction Companies v. Collector, 223 Fed., 984;
Philadelphia Traction Co. v. McCoach, 224 Fed., 800; affirmed, 233 Fed., 976;
Cambria Steel Co. v. McCoach, 225 Fed., 278;
People v. Sohmer, 112 N. E. Rep. (N. Y.), 181.
New York M. & N. Transportation Co. v. Anderson, 234 Fed., 590.

2. Receiving dividends from stock constituting practically the sole assets of the corporation, and distributing the same to stockholders:

United States v. Nipissing Mines Co., 206 Fed., 431.

3. Keeping up corporate existence, maintaining offices, paying salaries to officers and employees, voting stock owned in other corporations and receiving moneys accruing under leases and distributing the same to stockholders:

Public Service Gas Co. v. Herold, 227 Fed., ~~500~~ 496

4. Keeping up corporate existence, owning property, maintaining offices, transferring shares of capital stock, collecting rents and distributing the same in part, and investing the remainder and collecting and distributing the income therefrom:

McCoach v. Minehill Co., 228 U. S., 295;
Miller v. Snake River Co., 223 Fed., 946;
Cambria Steel Co. v. McCoach, 225 Fed., 278.

5. Making improvements upon property leased pursuant to provisions of the lease:

Miller v. Snake River Co., 223 Fed., 946.

6. Selling lands not needed by corporation or by its lessee:

Miller v. Snake River Co., 223 Fed., 946.
Traction Companies v. Collector, 223 Fed., 984.

7. Exercising the right of eminent domain in aid of lessee:

N. Y. Central Co. v. Gill, 219 Fed., 184;
Lewellyn v. Pittsburgh Ry. Co., 222 Fed., 177.

8. Paying and cancelling bonds after leasing property and retiring from business:

Miller v. Snake River Co., 223 Fed., 946.
Philadelphia Traction Co. v. McCoach, 224 Fed., 800.

9. Executing contracts to extend term of existing bonds, after leasing property and retiring from business:

Philadelphia Traction Co. v. McCoach, 224 Fed., 800; affirmed, 233 Fed., 976.

10. Issuing bonds for benefit of lessee pursuant to terms of lease:

Anderson v. M. & E. R. R. Co., 216 Fed., 83;
N. Y. Central Co. v. Gill, 219 Fed., 184;
Traction Companies v. Collector, 223 Fed., 984.

11. Assuming and paying off mortgage indebtedness after leasing property:

State Line Co. v. Davis, 228 Fed., 246.

12. Inspection of leased properties by lessor:

Public Service Gas Co. v. Herold, 227 Fed., 496;
Public Service Ry. Co. v. Herold, 227 Fed., 500.

13. Receiving and distributing principal and interest derived from the sale of corporate properties:

Bryant & May v. Scott, 226 Fed., 875.

14. Bringing injunction suits to protect leased property:

Traction Companies v. Collector, 223 Fed., 984.

In every case the question is determined not by the power to act, but by the actual activities engaged in by the corporation.

Flint v. Stone-Tracy Co., 220 U. S., 107, 145, 151;
United States v. Emery, Bird, Thayer Realty Co., 237 U. S., 28, 32;
Minehill Company v. McCoach, 192 Fed., 670, 672;
Public Service Ry. Co. v. Herold, 227 Fed., 500;
State Line Co. v. Davis, 228 Fed., 246, 249.

In each of the cases cited, with a single exception, the corporation charged with doing business, *and held by the courts not to be so engaged,* maintained independent offices, retained and paid many salaried officers and employees, were busied in various activities, brought suits for the protection of their property interests and for the benefit of their lessees, etc. But all such acts were in preservation of their rights as owners and not in the way of conducting trade, and did not subject them to taxation. The respondents were moribund in comparison with any of these, except the Bryant & May corporation.

Holding in the Cases at Bar in District Court.

In the court of first instance, *Judge Willard* was of the opinion that the respondent companies were engaged in carrying on and doing business, and, therefore, subject to the excise tax. He

distinguished (page 115) the present cases from the case of *Zonne v. Minneapolis Syndicate,* 220 U. S., 187, by the statement that, so far as the report of that case shows, the owner had nothing to do with *the management* of the business of its lessee; it had no supervision over the renting of the building, and no interest in supervising it. He adverted to the fact that the respondents here had the right to inspect work done on their lands, and that they exercised that right for the purpose of seeing that the operations were properly conducted.

This fact, in his judgment, distinguished also the *Minehill Case* and the *Nipissing Case.*

It is submitted that this attempted distinction is not warranted. The details of the contracts involved in the cases so distinguished do not appear in the reports; but we assert, without any fear of contradiction, that, even if there were not reserved to the lessors in those cases, in express terms, the right of inspection to enable them to ascertain whether their lessees were using or operating the premises involved in a proper or lawful manner, such lessors were not precluded, for that reason, from exercising the right of inspection for their own protection, or from taking such action, by legal proceedings or otherwise, as would preserve their rights and their property interests.

It will be observed that there is nothing in the mining contracts, illustrated by Exhibits 15 and 16 in these cases, which suffers, or was intended to permit, any supervision of the work carried on under the mining contracts in the sense of *managing, controlling, regulating, or otherwise taking part in it.*

Again *Judge Willard* emphasized (pages 115-6) the fact that the companies, during the three years in question, were engaged in selling real estate, in selling stumpage from some property which had been burned over, and in leasing property to squatters in order more easily to evict them. In this connection he said:

"It is true that those matters were trivial, but they indicate that the companies were constantly supervising and caring for this property. It was their business, and in fact it was necessarily their business, because there was no one else to do it. They had to take care of that part of their property which was not leased, someone had to take care of it, and they did take care of it. * * * All these things indicate, to my mind, the doing and engaging in business. It was doing the business of handling a large property, selling lots and seeing that the lessees lived up to their contracts. If that is not engaging in business, I do not know what is."

We think that the learned trial judge failed to take into consideration the distinction between carrying on and doing business, as intended by the law and as it has been defined by the courts, and the inherent right of the *owner of property to inform himself as to its nature and condition, and to protect and to conserve it*; and we contend that none of the circumstances referred to by the District Judge was susceptible of a construction demonstrating that the respondents were carrying on or doing business. Their attitude cannot be regarded in a different light from that of an individual similarly situated, and it would be an extreme contention to assert that an individual was engaged in business, merely because he should take steps to ascertain the character or value of his property, and, having disposed of a portion of it by a lease or by an executory contract of sale, should exercise his undoubted privilege and reasonable right of informing himself, from time to time, as to whether his vendee or contractee was conducting himself lawfully as respects the property involved.

The analogy between individuals and corporations in this respect has since been observed and adopted by the courts.

Abrast Realty Co. v. Maxwell, 206 Fed., 333, 335;
Traction Companies v. Collector, 223 Fed., 984, 988;
Philadelphia Traction Co. v. McCoach, 224 Fed., 800, 803;
People v. Sohmer, 112 N. E. Rep. (N. Y.), 181.

"There is helpful analogy in observing an individual. It is not usually hard to decide whether he is still 'in busi-

ness,' or has retired; and, if the latter, he does not lose that character because here and there, in the receipt of his income, he does an act of business" (223 Fed., 988).

Holding in Circuit Court of Appeals.

The Circuit Court of Appeals arrived at a different conclusion touching the activities and operations of the companies. That Court announced:

> "Again, this excise tax was imposed on corporations for doing business in a corporate capacity. It is imposed on corporations 'doing business' and on those only. Corporations that are the owners of property not used in business, that themselves engage in no trading, mining or other like business for gain, but confine their activities to acts necessary or incidental to the protection of their property and its conversion into money, are not 'doing business' within the meaning of the Corporation Tax Act. These companies were such owners during the years 1909, 1910 and 1911, and, as has been shown, they not only so confined their operations, but in 1909, by an amendment of their articles of incorporation, *they disabled themselves from conducting any other operations or doing any business* within the true interpretation of the Tax Act. They were not, therefore, taxable under that Act, and, for that reason, the judgments below were right" (page 155).

Again, in its statement of facts (at page 144), the Circuit Court of Appeals said:

> "The companies are not and never have been mining companies; they never have operated any mines in any way; they never made but one lease and the terms of that lease were agreed upon before the corporation lessor was organized, and, after its organization, it signed the legal contract on these terms. These corporations are, and always have been, *mere owners* of the rights to collect from the lessees under leases made before the corporations were organized, and of the lands leased, whose only substantial value was the value of the ore therein."

Distinction Between Mere Ownership and Care of Property and Using it in Doing Business.

The attitude and activity of the respondents toward their respective assets have never been any other than that of *mere ownership*. Such attitude or activity does not warrant the imposition of an excise tax under the Act of 1909.

Flint v. Stone-Tracy Co., 220 U. S., 107, 150;
McCoach v. Minehill Co., 228 U. S., 295, 306;
United States v. Emery, Bird, Thayer Co., 237 U. S., 28, 32;
United States v. Nipissing Mines Co., 206 Fed., 431, 433;
Lewellyn v. Pittsburgh, etc., Ry. Co., 222 Fed., 177, 185;
Miller v. Snake River Ry. Co., 223 Fed., 946, 951;
Traction Co's. v. Collector, 223 Fed., 984, 988;
Philadelphia Traction Co. v. McCoach, 224 Fed., 800, 805; affirmed, 233 Fed., 976;
Cambria Steel Co. v. McCoach, 225 Fed., 278, 282;
Public Service Ry. Co. v. Herold, 227 Fed., 500, 501.

It will be remembered that from the very beginning the respondent companies never contemplated engaging in business, but were organized for the single purpose of providing an instrumentality for dividing the properties which their stockholders owned in common and which,—by reason of their numbers, their ages and their varying locations, and the danger of added complications by deaths, marriages or transfers of individual shares—could not otherwise, except with great difficulty and embarrassing delays, be managed or disposed of. All of the property of any value had been already turned over, or agreed to be turned over, to the exclusive possession, control and profitable enjoyment of others, and all that the corporations were called upon to do was to receive the payments fixed by the contracts and distribute them to their members, and to get rid, as occasion might offer, of the odds and ends of property not covered by the mining contracts.

The respondents were merely holding companies and their intended and actual activities were connected solely with the protection and partition of the property interests of their share-

holders; they had no concern whatever with conducting or carrying on any business with a view to profit or to any other end.

The distinction between *the use of property in business* and *the mere ownership of property* is clear and well recognized.

In the *Stone-Tracy Case*, *Mr. Justice Day*, in the course of the opinion of the Court, said (at page 149):

> "The *Pollock Case* construed the tax there levied as direct because it was imposed upon property simply *because of its ownership*. In the present case the tax is not payable unless there be a carrying on or doing of business in the designated capacity, and this is made the occasion for the tax measured by the standard prescribed. The difference between the acts is not merely nominal, but rests *upon the substantial differences between the mere ownership of property and the actual doing of business in a certain way.*"

Obviously the words "doing business *in the designated capacity*" and "the actual doing of business *in a certain way*" refer to the provisions of the statute imposing the tax upon corporations (1) organized under the laws of the United States, or of any State or Territory of the United States, (2) which are organized for profit, and (3) which have a capital stock represented by shares.

The respondents stand before the court in the position of mere owners of property, and such ownership does not subject them to taxation. They are simply incorporated gentlemen of leisure.

There must be something more than *ownership and care of property* to constitute "doing business."

In *McCoach v. Minehill R. R. Co., supra*, the company owned and operated a railroad for many years prior to 1896, in which year it leased its entire property to the Philadelphia & Reading Railway Co. for 999 years. The Minehill Company agreed to maintain its corporate existence and powers during that period, and to exercise the same whenever needful to enable its

lessee to enjoy all demised rights and privileges relating to the leased property. Since 1896 the entire property has been controlled and operated by the Reading Company, and the Minehill Company has not carried on any business in connection with its operation. It has, however, maintained its corporate existence, and an office at which stock-books for the transfer of its shares of stock are kept; has received the annual rentals, collected interest on its bank deposits and the income derived from a contingent fund established and invested by it, and has distributed a portion of its annual income to its stockholders in dividends.

Having been compelled by the Collector of its district, to pay a corporation tax based on the rentals so received, the suit was brought to recover the amount so paid, upon the ground that the corporation was not carrying on or doing business, and the right of recovery was sustained by this Court.

Mr. Justice Pitney, in delivering the opinion of the Court, said, as respects the immediate matter which we are considering:

> "In our opinion, the mere receipt of income from property leased (*the property being used in business by the lessee and not by the lessor*) and the receipt of interest and dividends and the like, and the distribution thereof among the stockholders of the Minehill Company, *amount to no more than receiving the ordinary fruits that arise from the ownership of property.* * * * The distinction is between (a) the receipt of income from outside property or investments by a company *that is otherwise engaged in business*, in which event the investment income may be added to the business income in order to arrive at the measure of the tax; and (b) the receipt of income from property or investments by a company that is not engaged in business, *except the business of owning the property*, maintaining the investments, collecting the income, and dividing it among its stockholders. In the former case the tax is payable; in the latter not."

In *United States v. Nippissing Mines Co.*, 206 Fed., 431, the Circuit Court of Appeals for the Second Circuit, held that the decision in the *Minehill case* was decisive of that case, and added:

> "The substance of the decision was that *the receipt of the ordinary fruits incident to the ownership of property is not the doing of a corporate business.* That which the Minehill Company did with respect to its investment was what the defendant did. *We are unable to see that it was engaged in any other business than that of owning property*—shares in another corporation—collecting the dividends, and distributing its income among the stockholders."

In *Cambria Steel Company v. McCoach*, 225 Fed., 278, the court said upon this subject:

> "That the land leased to the Steel Company is not to exceed 10,000 acres, and that the Iron Company under the lease is to hold any other land which it possesses or may hereafter acquire for the purpose of supplying from time to time to the plaintiff lands and mines in lieu of lands and mines then demised, which may from time to time be surrendered to the Iron Company by the Steel Company, and that it is then to transfer the reserve lands to the Steel Company, is not material, for as to these lands it is not carrying on any business, *for mere ownership of lands does not constitute carrying on business*, neither does it derive any income therefrom by which a tax for business might be measured. The further fact that certain stocks and securities essential to the control of the water supply and supply of materials for manufacturing purposes remain in the name of the Iron Company, and the income is paid by it to the Steel Company, is not indicative of the carrying on of business."

See also, in this connection, the language quoted from the decision in *Stevens v. Hudson's Bay Co., post,* page 131.

This substantial difference between the mere ownership of property and the actual doing of business in connection with it, was overlooked by the learned District Judge, for (at page 117), referring to the amendment of the articles of incorpora-

tion of the respondent companies in 1909, he said:

> "It is true that that amendment specifically mentions only receipts of the proceeds, but *it authorizes the corporation to own property.* The power to sell the property so that the proceeds can be received is necessarily implied by the article itself. The corporation owns the property; if it is to distribute the proceeds of the sale, it must itself make the sale, for no one else can do it. This is the theory upon which the corporations have proceeded."

Effect of Amendment of Articles of Incorporation.

Returning to a consideration of the principal question—that of whether the respondents were carrying on or during business during the years here involved—we find this further statement defining *Judge Willard's* position (at page 117 of the transcript):

> "I do not myself think that the amendment of the articles of incorporation makes any difference, so far as this case is concerned. The original articles authorized the company to engage in the business of buying and selling real estate. The amended article provides as follows:
>
> > 'The general purpose of the corporation is to unite in one ownership the undivided fractional interests of its various stockholders in lands, tenements and hereditaments, and to own such property, and, for the convenience of its stockholders, to receive and distribute among them the proceeds of any disposition of such property, at such times, in such amounts and in such manner as the Board may determine.' "

Then follows immediately the excerpt from his decision last above quoted.

The amendment of the articles of incorporation in these cases conforms almost precisely in its terms, and completely in its effect, to the amendment made by the *Minneapolis Syndicate* in the *Zonne case*, 220 U. S., 187.

In that case the Minneapolis Syndicate, a corporation, being the owner of a tract of land upon which it had constructed an office building, sold the building to certain individuals acting

as trustees, and, at the same time, leased to them the land for a period of 130 years. The corporation, after the execution of the lease, amended its articles of incorporation so as to provide that "the sole purpose of the corporation shall be to hold the title to the westerly half of block eighty-seven of the town of Minneapolis, now vested in the corporation, subject to a lease thereof for a term of 130 years from January 1, 1907, and, for the convenience of its stockholders, to receive and distribute among them, from time to time, the rentals that accrue under said lease and the proceeds of any disposition of said land." Thenceforward, the corporation performed no other function than to receive the rentals accruing under the lease and to distribute them among the stockholders.

This Court determined that, with the sale and lease mentioned, the corporation had practically gone out of business in connection with its property, and thereafter was not engaged in doing business within the meaning of the Act. Its receipt and distribution of the rentals—although the corporate organization was expressly continued for that purpose—was not the carrying on of business in such wise as to subject it to the corporation tax.

We are not able to distinguish in effect between the amended articles of these respondents and the amendment of the articles of incorporation of the Minneapolis Syndicate, nor was the Circuit Court of Appeals, which held, respecting the respondents: "—by an amendment of their articles of incorporation they disabled themselves from conducting any other operations or doing any business within the true interpretation of the tax Act" (page 155). In the *Zonne case* the Solicitor General, appearing for the United States, contended that the power to receive and distribute rentals *and the proceeds of any sale that might be made of the land, implied a power of bargain and sale, and, for that reason, of carrying on and doing business,* and that the actual receipt and distribution of rentals constituted

in fact the doing of business. This contention was answered by *Mr. Justice Day* in his opinion, at pages 190-1, as follows:

> "Upon the record now presented we are of opinion that the Minneapolis Syndicate, after the demise of the property *and reorganization of the corporation,* was not engaged in doing business within the meaning of the act. It had wholly parted with the control and management of the property; its sole authority was (a) to hold the title subject to the lease for 130 years, (b) to receive and distribute the rentals which might accrue under the terms of the lease, (c) or the proceeds of any sale of the land, if it should be sold. The corporation had practically gone out of business in connection with the property, *and had disqualified itself by the terms of reorganization from any activity in respect to it.* We are of opinion that the corporation was not doing business in such wise as to make it subject to the tax imposed by the Act of 1909."

It will be observed that the amended articles of the Minneapolis Syndicate authorized the corporation (1) to own property; (2) to receive the income from the lease already made; (3) to distribute such income to its stockholders; (4), by direct implication, if not in express terms, to sell the property; and (5), explicitly, to distribute the proceeds of such sale among its stockholders. These are the things which, in the opinion of *Judge Willard,* constituted carrying on or doing business.

Abrast Realty Company v. Maxwell, 206 Fed., 333, presents a similar state of facts. The Realty Company organized as a corporation with general business powers, acquired certain real property which it leased to its stockholders, and later, Dec. 26, 1911, *amended its articles of incorporation,* so as to limit its activities to the mere ownership and rental of such property, and applied the entire rent, first, to the payment of interest on mortgage liens, and then to the payment of dividends to the stockholders.

In the opinion filed in the District Court, it was stated (page 335):

"But an examination of this record makes it appear that the Abrast Company did nothing before the 26th of December, 1911, in a different way than it did after that time, and that by the change in the certificate of incorporation it relinquished merely powers which it did not exercise and for which, therefore, it could not be taxed. *McCoach v. Minehill & Schuylkill Haven R. R. Co., supra.*

The general situation is entirely similar to that of the individuals who owned the real estate in question, and who leased it to the Abraham & Straus firm prior to the formation of the corporation. If these individuals had maintained an office for the renting of real estate, and had, in connection with that office, managed the real estate and performed all the duties connected therewith, those individuals would be held to have been in the real estate business. But if, on the other hand, they merely had title to the property, executed a lease, and had the rent paid either to a trustee for division among the owners, or directly to themselves, it would not seem that these individuals could be said to have been in business, nor to have conducted a real estate business, and the only tax upon the right to do business, or upon the business itself would have to be levied directly upon the property involved.

So the plaintiff corporation has no property right in the form of business privilege, beyond the ownership of the real estate which is liable to a direct real estate tax, and which is not taxable under the United States statute in question."

The conclusion thus announced, met with the concurrence of a majority of the judges of the Circuit Court of Appeals.

Maxwell v. Abrast Realty Co., 218 Fed., 457.

In the case of *McCoach v. Minehill Mining Company,* where the doctrine of the *Zonne case* was adhered to by this court, *Mr. Justice Day,* who wrote the unanimous opinion in the *Zonne Case*, dissented, and attention is directed to that opinion as indicating very clearly the significance to be attached to the amendment of the articles of incorporation. *Mr. Justice Day*, referring to the fact that the Minneapolis Syndicate had not only practically gone out of business, but, by the amendment of its articles, "had disqualified itself from any activity

in respect thereof, and, therefore, did not come within the scope of the Act," added, "in the present case the corporation has *not* disqualified itself from business activity," thereby evidencing his conviction that the fact of amendment constituted a material element to be considered, and created a vital distinction between the two corporations.

Manifestly, the amendment of their articles of incorporation by the respondents cannot be ignored in the determination of these cases; if they accomplish nothing else, the amendments conclusively disclosed the purpose of the respondents to refrain thereafter from carrying on or doing business.

Disqualification Otherwise to do Business also Exempts from Taxation.

It is further submitted that, by the transfer of their mineral properties to their respective lessees,—*who alone by reason of their exclusive right of possession, control and operation of the same, could thereafter carry on business in connection therewith,* by exploring and developing the mines and extracting and disposing of the ores—the respondents disqualified themselves from doing business quite as effectually as they did by the amendments of their articles of incorporation.

This was held by the Circuit Court of Appeals for the Second Circuit in *Anderson v. Morris & Essex Ry. Co.*, 216 Fed., 83. In that case the Court said (page 691):

> "The meaning of the words 'carrying on or doing business' and 'engaged in business' must be given their ordinary and natural signification, and, given that signification, the act done is not within the meaning of the statute. The lessor company was not an actively operating concern. Under the terms of this lease *the lessor corporation had practically gone out of business and was disqualified from any activity respecting the operation and managment of the railroad business which it had been incorporated to carry on.*"

It appeared that the Railroad Company had, prior to the year 1909, leased its railroad and branches and all its other properties, the consideration of the lease being the assumption by the lessee of the bonds and other obligations of the lessor and its agreement to pay the principal and interest thereon, to pay all taxes which might be imposed on the lessor, its business, income or property, and also to pay a certain annual percentage upon the capital stock of the lessor. The act referred to was the issuance of certain bonds to cover the cost of construction work done on the property by the lessee.

The decision last cited was followed by the Circuit Court of Appeals for the First Circuit in *New York Central Company v. Gill*, 219 Fed., 184, in which *Judge Putnam*, speaking for the Court, after quoting that portion of the opinion above set out, added:

> "This was a sensible interpretation of the statute and one in harmony with its general terms and purposes."

In the case of *Lewellyn v. Pittsburgh Railway Co.*, 222 Fed., 177, we find this language, at page 186:

> "It is not claimed that the plaintiff corporations, the lessors, were operating the leased roads when the taxes were assessed, and it is not denied that they had gone out of the business of transportation and *no longer received profits from the railroads otherwise than determined by the leases, nor is it denied that by the leases the plaintiff railroad companies had so placed themselves that they could not have engaged in the business of transportation over the leased lines, even had they wanted to.* In other words, the plaintiff railroad companies, the lessors, *had disqualified themselves to carry on or do the business,* either of operating, managing or conducting transportation over the leased lines."

These words are peculiarly apt when applied to the situation of the respondent companies. The absolute and exclusive possession, control and right of operation of their mineral lands had been transferred to others long before the enactment of

the corporation tax law, in consideration of the payment to the respondents, respectively, of stated sums per ton of ore removed, all taxes and expenses of every name and nature to be paid by the lessees. By the execution of these mining contracts, the respondents had so placed themselves that, had they desired to do so, they could not have engaged in the business of exploring for, mining, removing or disposing of any part of the iron ore contained in the lands; they had wholly disqualified themselves for carrying on or doing any business in connection with their properties which possessed any substantial value.

In the *Minehill case,* 228 U. S., at pages 303-4, this Court said:

> "From the facts as stated above, it is entirely clear that the Minehill Company was not, during the years of 1909 and 1910, engaged at all in the business of maintaining or operating a railroad, which was the prime object of its incorporation. This business, by the lease of 1896, it had turned over to the Reading Company. * * * The effect of * * * the lease * * * was to constitute the Reading Company the public agent for the operation of the railroad, and *to prevent* the Minehill Company from carrying on business in respect of the maintenance and operation of the railroad so long as the lease shall continue."

Likewise, in *United States v. Whitridge,* 231 U. S., 144, 149, the principle here contended for was again expressed as follows:

> "The possession and control of the receivers constituted, on the contrary, *an ouster of corporate management and control,* with the accompanying advantage and privileges."

Emery, Bird, Thayer Realty Co. v United States, 198 Fed., 242, presents a situation quite similar in its facts to *Zonne v. Minneapolis Syndicate.* Referring to that case, the District Judge said:

> "The only difference between that case and the case at bar which could possibly militate to the disadvantage of the plaintiff is, that here there has been no act of reorganization of the corporation by the terms of which it has disqualified itself from any activity in respect to the property. *But by its lease it has done so as effectively as did the Minneapolis Syndicate.* There the property was leased to trustees at a fixed sum and for a long period. In each case, the lessor has wholly parted with the control and management of the property, provided of course, the terms of the lease are observed" (page 251).

The cases at bar are even stronger than those of the *Minneapolis Syndicate* and the *Emery, Bird, Thayer Realty Co.,* for those Companies, owning their lands and at liberty to treat them as they might determine, themselves disposed of them by long term leases, and, to that extent, at least, transacted some business respecting them. The respondents, however, have never owned an unrestricted title to the lands which were conveyed to them by their stockholders, but acquired what, in the last analysis, is a mere equity—the legal title it is true, but a naked title, because the element of value in the lands had already been disposed of to others by executory contracts, and the respondents' only property right therein of value was the right to receive the moneys to be paid under those contracts by the lessees, in return for the ore which they acquired thereunder.

The Lessees, and not the Lessors, are the Corporations Engaged in Business, and Therefore Taxable.

It will be borne in mind that, under the mining contracts involved in these cases, the lessees are given the exclusive right of exploring for, mining and owning the merchantable iron ore therein for periods more than sufficient to permit the extraction and shipment of all such ore. The only right reserved by the respondents was that of entering upon the premises (not inter-

fering thereby with the enjoyment thereof by the lessees), for the purpose of observing the operations which might be carried on, and of measuring the amount of ore mined and removed (Decision of Court of Appeals, pages 148, 149, 151). As we have seen, practically the entire income of the respondent companies was derived from the moneys paid on these mining contracts as the consideration for the rights thus given to the lessees.

> "The companies are not and never have been mining "companies; they never have operated any mines in any "way (Decision of Circuit Court of Appeals, page 144); "* * * neither of the three corporations has ever bought, "explored, developed, leased or improved any lands, tene- "ments or hereditaments (*Idem*, page 145); * * * the "*lessees* extracted the ores from the lands from year to "year, and exhausted and paid in full for the ores cov- "ered by many of the leases before the Act of 1909 took "effect (*Idem*, page 146); * * * and the corporations "[respondents] have not engaged in mining, trading or any "other business (*Idem*, page 151)."

As further declared by the Circuit Court of Appeals (page 155), corporations that are the owners of property not used in business, that themselves engage in no trading, mining or other like business for gain, but confine their activities to acts necessary or incidental to the protection of their property and its conversion into money, are not doing business within the meaning of the Corporation Tax Act, and in that situation these respondents were during the years 1909, 1910 and 1911.

Equally undeniable is the fact that all of the property of the respondents which was used in business was so used *by the lessees under the mining contracts,* in the opening and developing of mines upon the premises, and the extraction and sale of ore therefrom. So doing, each of the *lessees* was subject to the corporation excise tax as being a corporation carrying on

and doing business, and in such cases, inasmuch as the law does not contemplate double taxation in respect of the same business, the respondents are exempt from the payment of an excise tax on account of the operations conducted upon their properties

Accordingly in *Minehill Co. v. McCoach,* 192 Fed., 670, *Judge McPherson* held:

> "It seems to be enough to say that the Reading Railway, and not the plaintiff, is doing the corporate business originally intrusted to the plaintiff, and presumably is also being taxed for carrying it on. It seems hardly possible that both corporations can be taxed in respect of transporting the same freight and passengers."

These conclusions were approved here (228 U. S., at page 304), this Court saying:

> "It is the Reading Company, and not the Minehill Company, that is 'doing business' as a railroad company upon the lines covered by the lease, *and is taxable because of it. The Corporation Tax Law does not contemplate double taxation in respect of the same business.*"

It was similarly held in *United States v. Whitridge,* 231 U. S., 144.

Certain lines of street railway in the City of New York were in the hands of Whitridge, as Receiver, under orders made by the United States Circuit Court in the year 1908. In the year 1911, petitions were filed in behalf of the United States praying for orders directing the Receiver to make returns of the net income of the railway corporations for the years 1909 and 1910. The petitions were denied and the order so made was affirmed by this Court, upon the ground that *the business was not being carried on by the railway corporations which had owned the land, but by the Receiver,* who, under the order of appointment had, during the years named, the exclusive possession and control of the properties.

The United States District Court for the District of New Jersey, in the case of

Public Service Railway Company v. Herold, 219 Fed., 301, came to the same conclusion. The Rapid Transit Street Railway Company, operating a railroad line in Newark, New Jersey, leased its property and franchises, in June, 1893, for a long term of years and the lessee had taken possession of, and operated, the railway line and, as required by the terms of its lease, had paid the taxes assessed against the property. The Court found that the only business done by the lessor, since the making of the lease, had been the maintenance of its corporate existence, and the collection and distribution of the rental called for by the lease, and that, following the decisions of this Court, the company was not carrying on or doing business. In the opinion it is said, at page 305:

> "It is, in effect, conceded by the defendant that, upon the facts as stated, the decision in *McCoach v. Minehill Company,* 228 U. S., 295, leads to a ruling that the Rapid Transit Street Railway Company was not engaged at all in the business of maintaining or operating a railroad, which was the real object of its incorporation. *It had turned its business over.* * * * The effect of the lease was to make the Public Service Company the public agent for the operation of the railroad while the lease existed, and *it is the Public Service Railway Company which is doing business under the provisions of the lease and may be taxable.*"

In *Lewellyn v. Pittsburgh etc. Railway Company,* 222 Fed., 177, the Railway Company had leased its railroad, its rolling stock and equipment, and had surrendered to the lessee the entire possession, operation and control thereof. In consideration therefor, the lessee company agreed to pay taxes, to pay dividends at a certain rate upon the capital stock of the lessor and to pay interest upon the bonded indebtedness. The lessor undertook to maintain its corporate existence in order to hold title to the properties leased and to exercise its power of emi-

ment domain to acquire additional property when requested by the lessee. After the execution of the lease, and during the taxing years in question, the lessor, at the request of its lessee, exercised its power of eminent domain, the properties so acquired being immediately delivered into the possession of the lessee company and used exclusively by it.

It was claimed by the Government that the exercise of this right of eminent domain constituted doing business which subjected the corporation to liability for a tax under the Act of 1909. Such tax, having been assessed, was paid by the Railway Company, and the action was brought to recover the amount so paid.

The Circuit Court of Appeals for the Third District, affirming a judgment in favor of the Railway Company, said, at page 185:

> "Having acquired and constructed the lines of railroad, the plaintiff corporations proceeded to operate them and after a time they disposed of them by lease, conveying in each instance all real and personal property within their ownership, and all rights in connection therewith which, under the law, they could convey. By disposing of the properties under the terms of the leases, the lessor railway companies parted with all control and management of the same and *the right to possess, operate and manage the railroads became vested, and exclusively vested, in the lessee.* Upon the transmutation of property, there was a contemporaneous transfer of business activities. *What the owners of the railroads had done before, the lessee of the railroads does now. The profits which before went to the owners, now go to the lessee.* All rights to direct the policy, or participate in the operation and management of the roads have been transferred to, and are now vested in, the lessee. * * * When the lessor railroad companies were requested to exercise for the lessee their power of eminent domain, and in response did the acts which it is claimed amounted to 'doing business,' their acts were purely formal, constituting the dry exercise of power, *in which no profit inured to them, their rentals being established, and in which all advantage inured to the lessee, which was the one corporation then actually doing business in the sense of operating the roads to which the*

several companies bore different relations, and which, therefore, was the one corporation liable to be taxed for the privilege of doing that business."

Still another case is *Miller v. Snake River Railway Company*, 223 Fed., 946. There the Railway Company leased the railroad owned by it to the Oregon Railroad & Navigation Company, which thereafter operated the same. All expenses of maintenance and renewal, taxes on the property, and incidental expenses were paid by the lessee. The Snake River Company, having been assessed for the year 1910, under the law of 1909, brought its action to recover the amount of the assessment which it had paid under protest, and recovered a judgment therefor. The judgment was affirmed by the Circuit Court of Appeals for the Ninth Circuit, which held that the Railway Company was not liable to be taxed, because it was not doing business during the taxing year. Concluding its opinion, the Court used this language, found upon page 951:

> "One reason for holding that the lessor was exempt from the tax in the *Minehill case* was, that the lessee company was doing the business as a railroad company upon the lines covered by the lease and was liable because of it, and the corporation tax law does not contemplate double taxation in respect to the same business. So in this case, *the business of operating the railroad during the entire taxing year, 1910, was conducted by the lessee or grantee. They were taxable because of that business, and to impose a like tax on the lessor would be double taxation, which the law does not contemplate.*"

To the same effect is the decision of the District Court for the District of Connecticut, in the case of

Waterbury Gas Light Company v. Walsh, 228 Fed., 54.

in which it is held that a gas company, which has leased its plants and other physical property for a term of years, the business for which it was incorporated being conducted by its lessee, is not carrying on or doing business within the meaning of the corporation tax act and is not subject to be taxed

therefor, although it retains its franchises and organization and receives and disburses its income, and, under the terms of the lease, bears the expense of alterations, improvements and additions to its plant made during the term, and also has, during the term, applied for and obtained from the Legislature amendments to its special charter.

In *State Line Co. v. Davis,* 228 Fed., 246, the plaintiff railway company leased its coal mine, railroad and other property but thereafter maintained an office for the transaction of business, maintained its corporate existence and organization by the annual election of directors and officers, and received an income in the shape of rental, and distributed dividends to its stockholders. It held itself in readiness to resume the operation of its properties if the leases should be violated by the lessee, and in such leases it reserved the right to remove timber and to mine everything underlying its properties except coal. It paid interest on the mortgage indebtedness assumed by it and was preparing to liquidate and settle such indebtedness. It made annual returns of income, and kept and maintained stock books for transfer of its capital stock, and for the transaction of its other business.

It was held that these acts did not constitute a doing of business so as to subject the corporation to the corporate excise tax, as *it is not the power to act but actual activities in certain directions which constitute a doing of business* (at page 249); and the corporation having leased its railroad, which was the prime object of its incorporation, was not doing business as a common carrier (at page 250):

> "It may be safely asserted that the plaintiff was not doing business as a railroad company, during the years 1909 and 1910, over the lines and upon its property covered by its lease. *The business of serving the public as a common carrier, which was the prime object of its incorporation, was turned over to its lessee. For this purpose the*

plaintiff must be regarded as out of business, and the taxes, therefore, were unlawfully imposed."

See also *United States v. Nipissing Mines Co.,* 206 Fed., 431, 433.
Wilkes-Barre Traction Co. v. Davis, 214 Fed., 511.

In *Public Service Railway Company, et al. v. Herold,* 229 Fed., 902 (a decision by the Circuit Court of Appeals for the Third Circuit embracing seventeen different cases which presented questions of the same general character), the Court said, after referring to various decisions in which the Act of 1909 had been construed:

"The substance of this construction is that the statute imposes an excise, not because of every act performed by a corporation under its incidental powers, but upon the privilege of doing and carrying on the business for which the corporation is organized; *and when the corporation ceases the conduct of such business by turning it over to be carried on by another, it ceases to be subject to the tax so long as it does no act by which the resumption of its business is to be inferred."*

It is not asserted that any business activity, if any were ever indulged in, has been resumed by the respondents since January 2, 1907; while the facts of the continuing exclusive occupation of the respondents' properties by their lessees, and the carrying on of the mining operations thereon by the lessees exclusively, are unquestioned. The only business done is that of the lessees, and they have presumably been taxed therefor.

No Tax May be Imposed Unless Business be Actually Done.

This is sufficiently established by the decision of this Court in the *Corporation Tax Cases* as shown by the excerpts from that decision quoted upon page 37, *ante.*

In the subsequent case of *McCoach v. Minehill Company*, 228 U. S., 295, the facts in which have already been stated (*ante*, page 48), the precise question presented for determination was defined by *Mr. Justice Pitney*, as follows:

> "Whether the Minehill Company is 'doing business' in the sense in which the Realty Companies concerned in *Flint v. Stone-Tracy Company*, were doing business, or had gone out of business, in substantially the same sense that the Minneapolis Syndicate had done so."

It was concluded that, by reason of the lease of its property, the Minehill Company was not engaged at all in the business of maintaining and operating a railroad, which was the prime purpose of its incorporation, and on that account was not taxable for the years named, notwithstanding the circumstances that it retained its office with numerous employees, received rentals under its lease, that it distributed only a portion of the annual rentals, and had invested, and was each year investing, the balance, with a view to producing income for the benefit of the company.

The analogy between the *Minehill case* and the instant cases is very close.

The activities of the Minehill Company were much greater than those ascribed by *Judge Willard* to the defendant companies; and if the Minehill Company were not doing business within the purview of the Act of 1909, the defendants were not.

In *Public Service Electric Company v. Herold*, 227 Fed., 486, a gas, electric and traction company leased to the plaintiff, for a long term, all of its property and franchises, except certain property which the Court deemed negligible and the franchise to be a corporation. Thereafter, the company sold certain stocks and bonds by virtue of which it controlled a portion of the leased properties, and authorized the payment of the purchase money to a trustee to be used in improvements and betterments of the remainder; it subsequently authorized the is-

suance of certain bonds and directed the proceeds thereof to be paid to the plaintiff to reimburse it for moneys expended in improvements of the leased property. Later, insurance money, accruing upon policies held by the lessor on account of damages occurring by fire to certain of the leased properties, was turned over to the lessee to enable the restoration of the damaged premises.

The District Court laid down the following general rule, which, beyond peradventure, must now be recognized as sound:

> "Without attempting to arrive at any exact definition, but adverting to some general principles which would seem to be pertinent, it may be said that, where there has been a practical surrender of all of the lessor's rights to operate and maintain, reserving the right of corporate existence, and where the use of such reserve corporate power is only for preserving the property leased, or for enabling the lessee to do such things effectually as are reasonably incidental to the preservation of the property and the enjoyment by the lessee of the rights and privileges conveyed by the terms of the lease, there is not an engagement in business by the lessor" (page 489).

The court held, however, that the lessor company had used its powers to issue bonds with detailed care, and that the proceeds derived from the bonds were used, not merely for betterments, but for extensions which were much more than mere maintenance of the property and were not "reasonably incidental to the enjoyment of the originally leased property." It was accordingly held that the plaintiff was subject to taxation and was not entitled to recover a corporation excise tax which it had paid under protest.

This and a number of other cases involving substantially similar facts were later carried to, and heard by, the Circuit Court of Appeals for the Third Circuit, and were decided together *sub nom.*

Public Service Ry. Co., et al., v. Herold, 229 Fed., 902.

The decision in the case last referred to was reversed under the following announcement of principles applicable to all of the numerous cases affected by the decision:

> "The character of corporate business intended to be taxed is described by the law only by the general expression 'carrying on or doing business.' From the beginning, therefore, the courts have been called upon to construe the law and to determine what corporate acts constitute doing business within its meaning.
>
> "It was recognized at once that certain corporate acts concern only the maintenance of corporate existence, and have no relation to the conduct of the business for which a corporation is organized, while others are done and performed solely in furtherance of that business without relation to the maintenance of the corporate entity. It was conceded that, with respect to the former, the law does not impose a tax, and with respect to the latter, it does. Between these extremes appear corporate acts partaking of the nature of business transactions, but pursued under circumstances that indicated *the performance of contractual undertakings rather than the conduct of corporate business.* Such transactions were presented for adjudication in a number of cases pending but not decided at the time judgments were entered in the cases under review. These were, therefore, not available to the trial court in aid of its conclusions. These decisions rule the cases under review, not merely because of the similarity in fact and in principle to the issues here involved, but because of the breadth of construction which the courts have given the statute.
>
> "The substance of this construction is, that *the statute imposes an excise, not because of every act performed by a corporation under its incidental powers, but upon the privilege of doing and carrying on the business for which the corporation is organized; and when the corporation ceases the conduct of such business, by turning it over to be carried on by another, it ceases to be subject to the tax so long as it does no act by which the resumption of its business is to be inferred.*"

After citing many of the authorities already referred to in this brief, the decision proceeds (at page 908):

> "A review of the reasons upon which these decisions are based would add nothing to the subject. It is therefore

sufficient to say we are of the opinion that the acts found, by the special verdicts in the cases under review, to have been done and performed by the lessor corporations were not done or performed by them in the conduct of the body or substance of the business for which they were organized and from which they had retired when they turned over their property to their lessees, but were corporate acts performed under the incidental powers of the corporations pursuant to the terms of contracts into which they had entered."

Of the cases cited in this brief which were included in this decision are:

Public Service Ry. Co. v. Herold, 219 Fed., 301;
Public Service Electric Co. v. Herold, 227 Fed., 486;
Public Service Gas Co. v. Herold, 227 Fed., 496;
Public Service Railway Co. v. Herold, 227 Fed., 500.

Distinction Between Maintaining Corporate Existence and Doing Business.

A distinction is made between what are called the *primary* and the *secondary* franchises of a corporation, and the effect upon their liability to this special excise tax of their exercise of these respective powers.

By "primary franchises" is meant the corporate powers essential to the organization of the company, the maintenance of its existence, the acquirement of the instrumentalities requisite to the due pursuit of the particular purposes of its creation, the preservation of its properties and the receipt and disbursement of its income; that is to say, keeping in order the internal affairs of a corporation. "Secondary franchises," on the other hand, are recognized as the powers employed in accomplishing, by means of the property and instrumentalities acquired to that end, the basic aim and object of the organization of a corporation designed for gainful activity; that is, the secondary franchises of a corporation are the powers used in conducting the business for which it is created.

The Circuit Court of Appeals for the Second Circuit, considering the case of *Anderson v. Morris & Essex Ry. Co.*, 216 Fed., 83, said (at page 88):

> "The fact that the lessor company, retaining its *primary* franchises of corporate existence, maintained its organization, held an annual meeting of its stockholders, elected directors and amended the by-laws, and that its board of directors held a special meeting and elected officers and appointed an executive committee, cannot be regarded as doing business within the purview of the Act, for it was simply keeping up the corporate organization, and surely no one can claim that the Act of 1909 imposes any excise tax upon the primary franchises or maintenance of the corporate organization. There was nothing in all this that involved the exercise of any of the *secondary* franchises of the corporation."

So, in *Lewellyn v. Pittsburgh Ry. Co.*, 222 Fed., 177, 184, decided by the Circuit Court of Appeals for the Third Circuit, we find:

> "It may be accepted as established that corporate acts performed by a corporation in the exercise of its *primary* franchises, as the maintenance of its corporate existence, do not constitute 'doing business' within the meaning of the statute, nor do corporate acts which relate strictly to the internal affairs of the corporation and which do not include the exercise of its *secondary* franchises. The statute therefore distinguishes between corporate acts, and discloses an intention to impose a tax for the privilege of doing only those acts which constitute 'carrying on and doing business.' * * * But it is clear that the statute, as interpreted, *distinguishes between business transactions as well as between corporate acts*, and the application of the statute to a given transaction or act, whether partly business or entirely corporate in its nature, must, after all, be determined by its character and purpose. By purchasing and condemning property the plaintiff corporations performed acts which were both corporate and business in their nature. The purpose of the acts is disclosed by what was accomplished by them. By the acts done the corporations merely acquired the instrumentalities to do the thing and to carry on the business for which they were incorporated. There is a distinction between acquiring the instrumentalities to do business and the doing of business with the instrumentalities acquired."

Again, in *Philadelphia Traction Company v. McCoach,* 224 Fed., 800, where the Traction Company leased its physical possessions to another, with the exclusive management and control thereof, and thereafter received the stipulated rentals and distributed the same to its stockholders, and, in addition, retired outstanding bonds, made agreements for the extension of certain maturing bonds, etc., in the course of the opinion holding that the company was not liable to the corporation excise tax, the court stated:

> "It will be clear to every mind that, as long as it was operating its own road, collecting fares and paying the operating expenses incurred, it was engaged in street railway business. The receipt and distribution of the income among its stockholders would of itself, to some minds, be part of the business it was doing. To other minds this would be a distinct and separate thing, not the carrying on of the business, but the sharing of the profits from the business. The distinction may be brought out by calling to mind the somewhat analogous distinction between the purposes for which a corporation is formed, or the business it is to conduct, and the incidental powers conferred upon it as necessary or helpful to the carrying out of its corporate purposes. * * * Its business purposes and its powers might be few or many, but the distinction between powers and purposes would still be clear. This is true notwithstanding that the two things overlap in the sense that among the rights given and the powers conferred, is that to engage in the designated business. * * * A corporation or individual might be doing business no matter how small the volume; but a corporation which borrowed money and issued bonds, which it had the power to do, could not be truly said to be engaged in that business, unless that was the purpose of its incorporation. The mere fact of the receipt of moneys from the income of the business is not the test. It would be forcing the meaning of the phrase to say that one was engaged in railroad business simply because his income was derived wholly from railroad investments" (pages 803-4).

After reciting the acts of the company above referred to, which it was contended constituted doing business, the Court added (page 805):

"With respect to these acts, they are nothing more than acts necessary to the existence of the corporation and the distribution of its annual income. They do not necessarily indicate, nor indeed throw any light upon, the question of whether or not the company was doing business, and do not justify such finding."

This decision was affirmed, *sub nom. McCoach v. Continental Passenger Railway Co.*, 233 Fed., 976, by the Circuit Court of Appeals for the Third Circuit.

The distinction thus emphasized is clearly illustrated by the General Statutes of Minnesota (1913), §6151, which reads:

"Every corporation formed under the provisions of this chapter shall have power:

1. To have succession by its corporate name for the time stated in its certificate of incorporation.
2. To sue and be sued in any court.
3. To have and use a common seal and alter the same at pleasure.
4. To acquire, by purchase or otherwise, and to hold, enjoy, improve, lease, incumber, and convey all real and personal property necessary to the purposes of its organization, subject to the limitations hereafter declared.
5. To elect or appoint, in such manner as it may determine, all necessary or proper officers, agents, boards and committees, to fix their compensation, and define their powers and duties.
6. To make and amend, consistently with law, by-laws providing for the management of its property and the regulation and government of its affairs.
7. To wind up and liquidate its business in the manner provided by law."

The powers thus conferred on corporations are plainly what are spoken of as their *primary* powers, or those incidental to their existence as artificial entities. Any or all of those powers may be used without "engaging in business." We must look to the purposes set forth in its Articles or charter, to discover whether a company is carrying on or doing business, and, if those purposes are active and contemplate buying, selling, manufacturing, transporting, mining, or other enterprises for

gain, their regular pursuit will probably be considered a doing of business; but, if not exercised, the possession of such powers will not be so considered.

What, Then, Constitutes "Doing Business"?

We have already seen that no tax may be imposed under the Act of 1909 unless business be actually done; that there is a substantial difference between the mere ownership of property and the doing of business in connection therewith; and that a corporation which is the owner of business property, but which has placed the possession, control and enjoyment thereof exclusively in the hands of another, is to be regarded as having gone out of business and disqualified itself from activity in respect of such properties.

In the *Flint Case, Mr. Justice Day* defined business as follows:

> " 'Business' is a very comprehensive term and expresses everything by which a person can be employed. 'That which occupies the time, attention and labor of men for the purpose of a livelihood or profit.' "

It has been sufficiently demonstrated that, as respects their *mineral bearing properties* the possession, control and enjoyment of all of which had been transferred to others long before the enactment of the Excise Law, the respondents, during the years in controversy, were not "engaged in business."

Nor did the exercise of their reserved right to inspect the operations of their lessees change the fact.

Public Service Gas Co. v. Herold, 227 Fed., 496;
Public Service Ry. Co. v. Herold, 227 Fed., 500.

It would be absurd to say that, as respects their *non-mineral properties*, the respondents were engaged in business during those years. If they were, what kind of business was it? Certainly not that of buying, selling or dealing in real property,

for the sales were only trivial and incidental, and such as were made were negotiated by Mr. Longyear under irrevocable contracts, executed by the original individual owners, giving him the exclusive and continuing right to dispose of such properties. The petty licenses issued to squatters and the two or three sales of burned timber were, of course, negligible.

The mere sale of property as an incident of ownership is not doing business.

Miller v. Snake River Co., 223 Fed., 946, 951;
Traction Companies v. Collector, 223 Fed., 984.

Neither is the receipt of principal and interest derived from such sales.

Bryant & May v. Scott, 226 Fed., 875.

Nor the receipt of rents from lands owned but not used in business.

Zonne v. Minneapolis Syndicate, 220 U. S., 187;
United States v. Emery, Bird, Thayer Realty Co., 237 U. S., 28.

Concerning the expressions in the Act of 1909, "engaged in business," "carrying on business" and "doing business," the Circuit Court of Appeals of the Third Circuit said:

> "The three expressions, either separately or connectedly, convey the idea of progressive, continued or sustained activity. 'Engaged in business' means occupied in business; employed in business. 'Carrying on business' does not mean the performance of a single, disconnected business act. It means conducting, prosecuting and continuing business by performing progressively all the acts normally incidental thereto; and likewise the expression 'doing business,' when employed as descriptive of an occupation, conveys the idea of business being done not from time to time but all the time."
>
> *Lewellyn v. Pittsburgh Ry. Co.*, 222 Fed., 177, 185.

It would appear, then, that to carry on or do business connotes employment, effort, control and direction of activity for purposes of livelihood or profit, and such activity must be

sustained and not sporadic.

> "Doing business, in a legislative sense, is that which occupies the time, attention and labor of men for the purpose of livelihood or profit; a calling for the purpose of a livelihood; * * * An undispensable criterion of business is that profit is intended."
>
> *State v. Boston Club,* 45 La. An., 585.

Plainly, the moment that the element of profit is taken into consideration as a criterion of doing business, any contention that the respondents were so engaged must instantly fall. And the few disconnected transactions in which they indulged were not only without any element of resultant profit, but were incidental acts of ownership, as in the sales of timber to secure such salvage as might be gained from the burned trees; in the issuing of leases or licenses for the occupation of lands to enable them to assert and secure their right of possession summarily and without the delays of suits in ejectment, and in the disposition of town lots through Mr. Longyear, recognizing the validity and force of his pre-existing contracts with the Pillsburys. And all of these isolated transactions were in furtherance of the express aim of the organizations of the companies, namely, to procure, as opportunity offered, a partition of the individual property interests of their stockholders.

The authorities all sustain these assertions.

> *Miller v. Snake River Valley Ry. Co.,* 223 Fed., 946 (Circuit Court of Appeals, Ninth Circuit).

The Railway Company was the owner of a line of railroad which was leased by it in 1907 to the Oregon Railroad & Navigation Company for a term of five years and was thereafter operated by the lessee. All expenses of maintenance and renewal, taxes on the property and incidental expenses were paid by the lessee, but it was entitled to retain, from the stipulated returns, the cost of permanent improvements.

The Snake River Company, while the lease was in force, main-

tained its corporate existence by holding stockholders meetings, electing directors and appointing various officers; collected the rents and income accruing under the lease and otherwise; made transfers of stock of the corporation; invested corporate funds; through the agency of its lessee constructed warehouse tracks and tracks connecting its line with that of another railroad company; considered and adopted a plan to terminate the lease, and did terminate the same, and considered selling, and voted to sell, the property, and sold the same; from the proceeds of the sale, and before the close of the taxing year, it paid off and retired its bonded indebtedness; discharged other claims against it; paid its annual corporation license tax, etc.

The action was brought by the Snake River Company to recover from Miller, Collector of Internal Revenue for the District of Oregon, a corporation excise tax for the year 1910, which had been exacted by the Collector.

It was held that the Snake River Company was not engaged in business during the year 1910 within the meaning of the Corporation Tax Act and that it was not subject to the excise tax which had been imposed.

In the opinion delivered in the Circuit Court of Appeals it is said:

> "The sole question presented by the record is: Was the Snake River Company 'engaged in business' during the tax year 1910 within the meaning of the Act?"

The Court referred to *McCoach v. Minchill Railway Company*, 228 U. S., 295, and said:

> "That decision is decisive here in so far as the mere ownership of the property, maintenance of offices, the keeping up of its corporate existence, the transfers of stock, the collection of rents and looking after investments by the lessor company is concerned.
>
> "We will now consider briefly the points of difference between the two cases from the standpoint of the Government. * * * [The Court discussed the first suggested difference relating to a wide variance in the terms of the re-

spective leases, and then proceeded as follows.] The only other distinction pointed out between the two cases is the sale of the property by the lessor and the payment of its indebtedness during the taxing year. Had the lessor been organized for the purpose of buying, selling and leasing railroads, this sale would no doubt constitute engaging in business within the meaning of the law. But we do not understand that it was organized for any such purpose and the *mere sale of its property as an incident of ownership does not bring it within the statute.* One reason for holding that the lessor was exempt from the tax in the *Minehill Case* was that the *lessee* company was doing the business as a railroad company upon the lines covered by the lease, *and was taxable because of it,* and the Corporation Tax Law does not contemplate double taxation in respect to the same business. So in this case the business of operating the railroad during the entire taxing year 1910 was conducted by the lessee or grantee. They were taxable because of that business, and to impose a like tax on the lessor would be double taxation, which the law does not contemplate."

In *Graham v. Hendricks,* 22 La. An., 524, the Court said, referring to "business":

> "It implies operations conducted with a view to the realizing of profits which come from skillful purchases, barter, speculation and sale."

So, in *Harris v. State,* 50 Ala., 127, the phrase "engaged in or carrying on business" within the meaning of the State revenue law was held to mean *to pursue an occupation or employment as a livelihood or a source of profit.*

The Supreme Court of Rhode Island has defined a "business corporation" as one engaged in financial dealings; buying and selling; traffic in general; or mercantile transactions.

Greenough v. Commissioners, 74 At. Rep. (R. I.), 785.

Traction Companies v. Collectors of Internal Revenue, 223 Fed., 984 (Circuit Court of Appeals, Sixth Circuit).

Six cases were consolidated and tried together, being cases against a Collector of Internal Revenue to recover for taxes

paid under protest, which were assessed under the Corporation Excise Tax Law. The Traction Companies were suburban railroad companies which had leased their lines to an operating company for the full term of their franchises. Thereafter the lessor companies did only what was necessary to maintain their organization; collected their rentals and disbursed them in dividends and otherwise; but, in accordance with the provisions of the leases which gave the lessee the right to sell unimportant items of property, the lessors joined in conveyances of the property so sold, and, in one case, issued to the lessee treasury stock and bonds in payment for permanent improvements made by the lessee; in another case they permitted a suit to be brought by the lessee in the name of the lessors.

It was held that the companies were not engaged in or doing business within the meaning of the Act, and were not subject to the excise tax.

In the course of the opinion of the court it is stated, after referring to the *Park Realty Company Case*, 220 U. S., 107, and *Zonne v. Minneapolis Syndicate*, 220 U. S., 187:

> "When we compare these two cases, by themselves, and as they have been interpreted in the *McCoach case*, in *United States v. Whitridge*, 231 U. S. 144, and in *United States v. Emery, Bird, Thayer Co.*, 237 U. S. 28, we think the true test of distinction must be, as applied to corporations of this class, whether they are continuing the body and substance of the business for which they were organized and in which they set out, or whether they have substantially retired from it and turned it over to another. If the latter appears, then their tax exempt status must be tested by the further query whether they have, during the critical period, done only such acts as are properly and normally incidental to the status of a mere lessor of such property or whether they have exercised their peculiar corporate franchises outside of and beyond the fair scope of that statute."

Anderson v. Morris & Essex Railroad Company, 216 Fed., 83 (Circuit Court of Appeals, Second Circuit).

The Railroad Company brought the action to recover a cor-

poration excise tax for the year 1910, exacted by the Commissioner of Internal Revenue and paid under protest. The company had leased its railway property and franchises for the whole term of its charter, the lessee having exclusive control of the property and conducting the operation of the railroad. The company, however, retained its franchise as a corporation, maintained its organization, held annual meetings of stockholders, elected directors, amended its by-laws and received and disposed of the rentals accruing under the lease. On the 31st day of December, 1910, it executed and delivered to the lessee its bonds for a considerable amount to reimburse the lessee for moneys expended by it in construction work on the railroad property of the lessor.

The court held that none of the acts referred to constituted carrying on or doing business by the lessor company.

Referring to the issues of bonds, the court said (page 91):

> "The meaning of the words 'carrying on or doing business' and 'engaged in business' must be given their ordinary and natural significance, and, given that significance the act done is not within the meaning of the statute. The lessor company was not an actively operating concern. Under the terms of this lease, the lessor corporation had practically gone out of business and was disqualified from any activity representing the operation and management of the railroad business which it had been incorporated to carry on. The issue of the bonds was an act done simply to enable the lessee to enjoy, use and exercise the property, franchises and rights which the lessee had previously demised, and did not amount to the resumption of business which the lease had transferred, or a 'doing of business' in the statutory sense."

Bryant & May v. Scott, 226 Fed., 875.

Plaintiff, a foreign corporation, had engaged in the business of manufacturing matches in the State of California, and in that connection acquired, jointly with the Diamond Match Co., a large acreage of timber land. In 1898 it sold out its business and its interest in the land to the Diamond Match

Co. under an executory contract which provided for partial payments running through a period of years, and, until such payments were made, the retention by the plaintiff of the legal title to its interest in the property as security therefor. The purchaser agreed to pay all taxes and assessments upon or against the property after the date of sale. Since that date the plaintiff engaged in no business in the State other than to maintain an agent there, designated in obedience to the requirements of the California code relative to foreign corporations, and to retain an attorney to look after and protect its rights under the contract, and to supervise the final transfer of title, which was made in 1912.

The defendant Scott, as Collector of Internal Revenue, exacted from the plaintiff payment of a corporation tax under the Act of August 5th, 1909, for the four years 1909 to 1912, both inclusive, which payment was made by plaintiff under protest, and this action was afterward brought to recover the amount so paid.

The court adverted to the holding of this court that the tax is "neither upon the franchise, the capital stock nor the income of the corporation, but is a tax upon the doing of business, with the advantages which inhere in the peculiarities of corporate or joint stock organization." *Flint v. Stone, Tracy Co.,* 220 U. S., 107, 145. It declared that this has reference to no merely sporadic or incidental acts or transactions, but to a carrying on of the business in which the corporation was organized to engage; that, under the authority of *McCoach v. Minehill Ry. Co.,* 228 U. S., 293, and *Zonne v. Minneapolis Syndicate,* 220 U. S., 187, the plaintiff was not within the act as a corporation subject to the taxes. It said (page 877):

> "The mere retention of the legal title to the property sold, as security for the purchase price, and the continuance of plaintiff's corporate capacity in the State for the protection of its rights under the contract and to receive the deferred payments of principal and interest, do not

constitute doing business in the sense of the statute. If the functions being performed by the corporations in the above cases (228 U. S. 295; 220 U. S. 187), do not constitute carrying on business, it is quite obvious that what was left to be done by the plaintiff at the time of the assessment here in question cannot be so characterized, since manifestly, there can be no well-founded distinction, so far as constituting the doing of business, between the functions of receiving and distributing to stockholders the *income* from invested funds, as in those cases, and *the receipt and distribution to the stockholders of the principal and interest derived from property sold*—that is, where, as here, the selling of the property is not in pursuance of the business for which the corporation was organized, but for the purpose of retiring therefrom. Indeed, the performance of the former functions, being more permanent, would seem to be more in the nature of carrying on business than the latter."

Accordingly, the plaintiff was held entitled to recover the payments exacted as Corporation Taxes for the years named.

The moneys received by the respondents here were of the same character as those thus passed upon. They constituted the deferred payments of proceeds of ores disposed of under contract before the excise law was enacted to exactly the same extent as did the moneys received by Bryant & May.

From the outset the respondents were practically mere *trustees* of the lands of their stockholders, holding the title for the single purpose of liquidating the property and distributing the proceeds to those entitled thereto; or, to use the illustration employed by *Judge Sanborn*, after describing the functions of the land companies (page 151):

"The reason for these acts was that the interests of the owners were undivided, that they were so numerous and of such ages and conditions that the partition of the property in kind, or by the conversion into money and the distribution of it, had become imperative, and the owners determined to effect it. Any one of these owners had the equitable right to such a partition. If one or more of them had petitioned the proper court for such relief and

> the court had appointed a receiver or master to collect the claims for the purchase price of the ore, or royalties, and to convert the property into money and distribute it among the owners according to their respective interests, could any court lawfully have held that the proceeds thus obtained were the gain, profit or income of the equitable owners? These corporations stood in the same relation to the claims for the purchase price of the ore, or the royalties, and the moneys they collected from them, and to the equitable owners of the property, their stockholders, that such receiver would have stood. In reality they received and held these claims and the moneys collected from them in trust to distribute them among the equitable owners of the property."

The position thus taken by the Circuit Court of Appeals is sustained by

People v. Sohmer, 112 N. E. Rep. (N. Y.), 181,

which was a proceeding in the Court of Appeals of the State of New York, to review, by writ of certiorari, the imposition of a tax upon a corporation assessed for the privilege of doing business in the State, it appeared that a railway company leased to the Lehigh Valley Railroad Company all its property, real and personal, and franchises, except the franchise to be a corporation, for a term of 999 years, the lessee agreeing to operate the railroad during the term, to pay the principal and interest of the lessor's bonds, and, as rental, to pay the net income to the holders of the lessor's capital stock. During the year for which the tax complained of was assessed, the lessor company did nothing in the State except to keep alive its corporate existence, holding an annual meeting of the stockholders for the election of officers, etc.

The language of the tax law was as follows:

> "For the privilege of doing business or exercising its corporate franchises in this State every corporation, joint stock company or association doing business in this state shall pay the state treasurer annually, in advance, an annual tax to be computed upon the basis of its capital stock employed during the preceding year within this State, and upon each dollar of such amount."

The Court of Appeals held that the statute must be applied as it speaks and that, in the absence of uncertain or questionable language, rules of construction cannot be invoked.

The opinion continues:

> "The appellant was not, within the year in question, doing business in this State. Its sole activity was to maintain its corporate existence. In the world of business and industry *it was merely the depositary of the naked legal title of the property and franchises* which it had acquired and demised many years prior. In case it had been an individual it would not be seriously argued, we think, that the individual was doing business. In case the appellant were a foreign corporation it would not be seriously argued, we think, that it was doing business in this state."

No material difference between the language of the New York statute and that of the Corporation Excise Act of 1909, as respects the meaning of the term "carrying on or doing business," is observable.

The respondents' situation was similar to that disclosed in the case of

Smith v. Anderson, L. R., 15 Ch. Div., 247.

Under the English Companies Act of 1862, it was provided that no association or partnership of more than twenty persons should be formed for carrying on any business *that had for its object the acquisition of gain*, unless it were registered under the statute referred to. The law is not fairly distinguishable from the Act of August 5 in respect of the companies or associations to which it was applicable. Both laws were enacted with exclusive reference to companies organized for profit, carrying on business.

In the English case it appeared that a number of persons (more than twenty) had contributed money to be invested by five of their number selected by them for that purpose (referred to as trustees) in various securities bearing a high rate

of interest.

The scheme was for these five trustees to receive the income from such securities and to pay a certain part thereof to the contributors, in accordance with their respective interests, and to use the surplus in retiring at par, from time to time, the certificates which they issued showing the respective contributions of the members to the original fund, and, after all the certificates had been retired, either out of surplus income or by the sale of certain of the securities, to divide the securities remaining *pro rata* among the members.

One of the members became dissatisfied and applied to the courts to wind up the affairs of the association upon the ground that they came within the [illegible]sion of the Companies Act and that, not having been re[illegible]ereunder, the association was unlawful. *Lord* [illegible]*s* said:

> "Supposing that the c[illegible]ers did constitute an association, it appears [illegible] that it cannot, in the practical sense of the word [illegible]siness,' in any sense in which any man of business would use that word, be said that the association was formed for the purpose of *carrying on* any business, either by themselves or by an agent. * * * In my opinion, nothing that is to be done by the trustees comes within the ordinary meaning of 'business' any more than what is done by the trustees of a marriage settlement, who have large properties vested in them, and who have very extensive powers of disposing of the investments, changing the investments, and selling them, and reinvesting in other investments according to their discretion and judgment, with or without the consent of their *cestuis que trustent*. That is not a business."

In a concurring opinion, *Brett, L. J.*, said:

> "The expression 'carrying on' implies a repetition of acts and excludes the case of an association formed for doing one particular act which is never to be repeated. That series of acts is to be a series of acts which constitute business. Now the word 'business' might, in a grammatical sense, include things which no ordinary person would call business, and, inasmuch as the Legislature could not particularize every particular kind of business which

> they intended to include, they have, in order to confine the meaning of the word business, stated that it is to be a business 'that has for its object the acquisition of gain.' The association, then, must be formed in order to carry on a series of acts having the acquisition of gain for their object."

He then considered the purposes of the association, concluded that the members were not associated for the purpose of speculating in shares; that there was no reason why, when they had once made an investment, it should, under ordinary circumstances, ever be changed, and announced as his opinion that the primary and substantial object of the association was not for the purpose of carrying on business, which, if successful, would result in the acquisition of gain.

Of course, the application of this decision to the cases in hand is obvious. The capital assets of the respective respondents consisted in the lands conveyed to them by their stockholders, not for the purpose of sale and investment of the proceeds in other lands with a view to pecuniary profit or other advantage, but with the exclusive design, for the convenience of the stockholders and the economical management of the property, of converting it into money which could be distributed to the stockholders in proper proportions. Such conversion cannot, in any reasonable definition of the term, be deemed carrying on or doing business, and, even if it were so considered, it is plain that no element of profit is involved in such transaction in the proper acceptation of the statutory term, which recognizes as income or profit the gain from trafficking in property in any lawful manner with a gainful purpose.

A third opinion was delivered in the case last cited by *Lord Justice Cotton.* Referring to the Companies Act, he said:

> "We have in the first part, without any reference to gain or anything else, a description of the business which com-

panies in the first part of it are formed to carry on. Then in the second part, we have a reference to companies carrying on any other business, with this qualification, that the business must be one for the acquisition of gain by the company, association or partnership, or by its members. That, in my opinion, shows that the words, 'for the purpose of carrying on any business which has for its object the acquisition of gain,' are material."

Summarizing the facts in the cases at bar, it appears without contradiction that the Land Companies were organized in 1906 without any purpose of carrying on or doing business through them, but to attain a feasible means of handling the properties conveyed to them, of collecting the moneys accruing therefrom, and of distributing the same to the individuals interested therein, the ultimate aim being to bring about a partition of such interests without sacrifice, complication or unnecessary litigation or expense. Immediately after the enactment of the Excise Law, the articles of incorporation of the respective companies were amended so as to express with unmistakable distinctness these purposes, and the intention not to engage in business.

The companies maintained no offices, employed no clerks or bookkeepers, paid no salaries; such correspondence and bookkeeping as were needful were performed by Mr. Bennett's office force, a small charge for their time devoted to such matters being paid by the companies.

The companies did not explore, develop or work any mines, or smelt or sell any ores; they did not engage in any commercial pursuits, or make any investments, or strive in any manner for gain. Their only pecuniary receipts were stated payments falling due under contracts which the corporations did not make and which they were powerless to change or terminate; and those receipts were at once divided among the stockholders in pursuance of the main object of incorporation. The stockholders met once a year to elect directors, and the direc-

tors met periodically to authorize the treasurer, by a recorded resolution, to make the distributions referred to.

No company involved in any of the decisions which have been quoted, except Bryant & May, displayed so little activity.

It plainly follows that the respondents were not taxable in the years 1909, 1910 and 1911, with respect to carrying on or doing business, because, during such years, they were not so engaged but were merely exercising the rights incident to the ownership of property. As a result, the judgments of the Circuit Court of Appeals in these cases must be affirmed.

Should it appear to the Court, however, that the respondent companies were organized for profit, and that, during the years 1909, 1910 and 1911, they were engaged in business, so that a liability to pay the special corporation excise tax attached to them, it will become necessary for the Court to investigate the nature of the pecuniary receipts of the companies and to determine, after such investigation, whether any part of them constituted gross income, and, if so, what proportion of such gross income was net income by which the amount of the tax should be measured.

We turn our attention to those subjects.

POINT III.

The Respondents Received no Gross Income During the Years 1909, 1910 and 1911.

There is no controversy whatever as to the facts in the three cases. The amount of the actual money *receipts* of each of the respondents is unquestioned. The two points of disagreement between the respondents and the Commissioner of Internal Revenue are, *first*, as to whether such money receipts

represented income at all; and, if any part were income, *second*, what deductions therefrom, in addition to expenses and taxes conceded by the Commissioner, the respondents may lawfully claim.

The first of these points of disagreement will be taken up under this subdivision.

The Respondents' Contention.

The respondents assert that the receipts of money under the mining contracts during the three years in question represented merely a conversion of capital assets without gain or profit, and were not gross income.

This assertion is clearly sustained by the admitted facts.

What are the Facts?

The three companies were created without any purpose of trading or speculating, or engaging in any business activity with a view to gain, but their organization was compelled by the peculiar conditions existing with respect to the properties which were to be vested in them.

Those conditions were: That in 1892, an undivided one-half of the properties was owned by Messrs. Longyear and Bennett, and the other one-half was owned by John S., George A. and Charles A. Pillsbury. Between that time and October 8th, 1901, each of the three Pillsburys died, leaving numerous heirs. One of them, George A. Pillsbury, died testate. The others died intestate. By the will of George A. Pillsbury, a specific interest in the properties was devised to his widow, who died in March, 1901, leaving a will by which her undivided interest (1/18 of the whole) was devised to six grandchildren, except an interest in certain of the properties which, prior to her death, she had conveyed to two other relatives (pages 45-46). After the death of Governor Pillsbury in 1901,

the Pillsbury interests were widely distributed, some of the shares being as small as 1/108 of the whole, and many of the owners were children of tender age. These Pillsbury descendants, as well as Longyear and Bennett, were anxious to realize their several interests; they resided in various parts of the United States, and no disposition of any part of the properties could be made except by the assent (directly or through guardians appointed for the various minors) of all of these heirs. None of the guardians could act in any instance except upon special application to and authorization by the Probate Court by which they were appointed, and, as will be readily conceived, to secure such authorization required, in each instance, delays of weeks and months. Consequently, opportunities to dispose of portions of the property were frequently lost through inability to act thereon promptly, and the annoyance and expense attending the disposition of any interest were intolerable.

A further consideration leading to the organization of the respondents was the fact that certain of the heirs married, thus introducing additional parties to be consulted, and whose consent must be obtained, in the persons of their spouses. Some of the heirs had children, and, in case of the death of such parties, the complications would be multiplied.

A further distinct and ever present danger existed in the possibility of some one or more of the heirs disposing of his or her undivided interest, for the purpose of realizing at once his or her inheritance in a form available for any purpose to which such heir might desire to apply it.

For all these reasons the creation of the land companies became imperative, if a sacrifice of the individual, as well as the aggregate interests was to be avoided.

Another important factor was the peculiar situation of these properties. The lands, in tracts aggregating more than 10,000 acres, had been originally selected by Messrs. Longyear and Ben-

nett as promising to have large value on account of iron deposits, the existence of such deposits on portions of the land had been definitely ascertained, and the remaining portions were selected on account of the probability of valuable mineralization thereon. Before the organization of the corporations, all of the lands upon which there was any possibility of mineral being found had been carefully explored, and the boundaries, nature and content of the iron deposits had been determined. The exclusive and irrevocable right to occupy the lands and to mine and remove the ores where ore existed, had been granted (for terms more than adequate to permit the extraction of all of the ore) by the individual owners, except as to certain tracts embraced in the Van Buren Iron Mining Co. contract, but the negotiations for this contract had begun in the year 1905 and were concluded in 1906 before the organization of the respondent companies, which occurred in July, 1906.

Recognizing not only the difficulties attaching to the execution of a mining contract by or in behalf of the "Pillsbury heirs" (and having especially in mind a statute forbidding a guardian to make any contract touching the property of his ward extending over a period in excess of twenty-five years), the Van Buren Company required, as a condition for taking the unsold ores, that the properties should be vested in a corporation by which the contract, already negotiated by the heirs and their representatives, should be executed. This contract (Exhibit 16) was finally signed and delivered by the *Sargent Land Company*, in pursuance of this arrangement, on the 2nd day of January, 1907. With its execution all of the iron ore on the properties of the respondent companies was disposed of.

The remaining non-mineral bearing properties had no substantial value, and the only substantial value in the mineral bearing properties consisted in the ores which they contained. The retention by respondents of the portions of their proper-

ties which were not leased does not affect the question, since they were not used in business.

Cambria Steel Co. v. McCoach, 225 Fed., 278.

State Line Co. v. Davis, 228 Fed., 246.

The Nature of the Property Rights Acquired by the Respondents.

What was the effect of the mining contracts as respects the property rights actually acquired by the respondents? Under the terms of the mining contracts the grantees were given the exclusive possession and control of the property, and the exclusive right to mine, ship and sell the ore as their own. All taxes and assessments were paid by them. The only rights reserved to the fee owners were, to enter upon the premises for the purposes of observing and checking up the operations carried on by their grantees, and to receive a stated price per ton for the ore, *which price remained fixed and unchangeable, regardless of any variation in the market value of the ores.*

What the corporations received, therefore, was not, in fact, the ownership of the iron ore existing upon their lands, but the rights of the former individual owners to collect, under the outstanding contracts, the moneys that should become payable on account of the ores which the contracts had disposed of.

They were in the precise situation of an individual who buys from another his farm subject to a contract of sale already made; if the vendee under the contract fulfills his obligation to pay the purchase price, at the times and in the manner provided, the purchaser from the vendor is entitled to receive such payments, and, when they are completed, is obligated to convey to the vendee the naked legal title which he has received. The moment the contract of sale was made, although the vendor remained the legal owner of the farm, the vendee became the equitable owner, and the purchaser from the vendor acquires

nothing except the vendor's rights under the outstanding contract. The value of his investment consists, manifestly, in the unpaid purchase price still due upon the contract, and, as respects the farm, his capital which it represents is the sum of those payments; as the payments are made, his capital is returned to him for re-investment in other directions, and, unless there be specific provision for payment of interest upon the unpaid instalments, it is plain that he will receive no income, gain or profit over and above the return of his invested principal.

Such, precisely, was the condition of the respondent companies when the title to their lands was conveyed to them by the "Pillsbury Heirs" and by Longyear and Bennett. While they received the legal title to the lands, they took it subject to the outstanding contracts, pursuant to the terms of which they could receive, and anticipated receiving, nothing except the moneys which should become payable thereunder.

This situation was clearly recognized by the Circuit Court of Appeals and cannot be more clearly and accurately presented than in the language of *Judge Sanborn*:

> "Thus it was that these numerous owners of undivided interests in *the claims for the moneys which the lessees had covenanted by these leases to pay for the ore in these lands,* and of the lands themselves, had become so numerous and were of such ages that it was impracticable for them to make legal contracts or conveyances, and were likely to become still more numerous (page 145). * * * So it was that when the Act of 1909 took effect these corporations were the owners *of claims against the lessees* for royalties on ores in lands in Minnesota, under leases made before that Act took effect, and of the lands themselves, which had no substantial value without the ore (page 146). * * * The lands, and hence the property of the corporations, *had no substantial value without the rights to collect the royalties the lessees had covenanted to pay.* * * * In 1906 and 1907 these corporations took from the lessors the latters' *claims and rights to collect and receive from the lessees the royalties they had covenanted to pay*

for the ore, and the title to the lands, and issued their stock therefor. * * * On January 1st, 1909, when the Act took effect, and for years before that date, these corporations were the owners *of the claims and rights to collect and receive the amounts which the lessees had covenanted by the leases to pay for the ore in the lands*, and of the lands themselves. These things were their absolute property on January 1st, 1909, and none of them was any part of their subsequent income, gain or profit. The land was practically worthless; *the rights and claims to collect the amounts the lessees had covenanted to pay for the ores were practically all there was of value in their property*, and these were worth hundreds of thousands of dollars (page 148). * * * By the leases, the owners of the land granted to the lessees the absolute and exclusive right to take out and have all the ore in the land, and to remove it at any time within twenty-five to fifty years, a time so long that it was ample to enable them to remove all of it and is equivalent to an unlimited time, and the lessees agreed to pay a yearly fixed amount per ton for all the ore they should take, and to pay the minimum amounts annually, whether the ore was taken or not, and *the result was that the lessors granted a part of the corpus of the property, that by the grant the lessees were made the owners of the ore and the lessors the owners of the claims and of the rights to collect the amounts the lessees covenanted to pay for the ores*, and the transactions were in reality sales of the ore for covenants to pay the purchase price thereof (page 149). * * * But the truth is that the leases merely *changed the form of the property of the lessors from the ores to the rights and claims to the purchase price of the ores which the lessees covenanted to pay under the name of royalties.* * * * All of the ores sold by some of the leases has already been extracted, and *the claims for its purchase price*, or royalties, have been paid in full, and the claims for them have become worthless. The ore under one of the leases was exhausted in 1911 and the claim for its purchase price, or royalties, then became worthless" (page 150).

If these conclusions be accepted—and it is difficult to perceive how their acceptance can be avoided—the judgments under review must, of course, be affirmed.

Ignoring entirely this aspect of the case, the petitioner, in Point II of his brief, lays much stress upon the following statement made, *arguendo,* by the Circuit Court of Appeals (page 149):

> "A mining lease whereby the lessee is granted the absolute and exclusive right to dig for, remove and have the mineral in the land during terms sufficiently long to enable him to remove it is in reality a sale of the ore, and the royalties reserved are in fact the purchase price of it."

Certain Pennsylvania and English cases are cited in support.

The argument advanced by petitioner upon this subject requires brief attention.

Were the Mining Contracts Sales of Ore?

A. *The Claim of Petitioner.*—The petitioner insists that they are not, and that, in consequence, the moneys received by the land-owner thereunder constitute income. If his premise be granted the conclusion does not necessarily follow.

The statement of the Circuit Court of Appeals, above quoted, is criticised as having no support outside of "the peculiar Pennsylvania cases," and Lord Blackburn is quoted (page 11 of petitioner's brief) as holding that the argument is untenable that no income tax may be imposed upon proceeds derived from mines, although they represent instalments of purchase price of minerals forming a part of the land.

The reason for this holding was found in the peculiar provisions of the English Income and *Property* Tax Act.

The act classifies the several taxes imposed into five schedules. Of these Schedules A and D are the only ones here important.

Schedule A imposes a tax upon *property* in lands, tenements and hereditaments computed upon *the annual value* thereof, and Rule 3 under Schedule A provides that such annual value

shall be computed at a sum not less than the full amount of the average profits arising therefrom during a period of five years.

Schedule D imposes a tax upon trades, occupations and businesses computed upon the "gains or profits thereof." Rule 3 under Schedule D provides that no allowance can be made, by way of diminution, "for any sum employed or intended to be employed as capital in such trade, manufacture, *adventure* or concern."

In the *Coltness case,* cited by the Court of Appeals, it was held that mines in the United Kingdom were to be assessed under Schedule A, and the question arose as to the meaning of the word "profit" as a measure of the tax. *Lord Penzance* said:

> "My Lords, the argument of the appellants was based on the interpretation which they gave to the word 'profit' in the Act. And it was contended that they could not be properly said to have made any profit out of their mines until a certain portion of the cost of making the bores and sinking the pits, necessary to approach the mineral-bearing strata, were deducted.
>
> In a general, and perhaps a strict and logical sense, I think this is true. *But it is also, and equally true, I think, that the cost of the mineral strata themselves, whether they have been hired or bought, should be included in any calculation which had for its object the ascertainment of the actual profit* obtained by the company out of the entire adventure,—so much for the prime cost of the mineral bed, so much for approaches to it in the shape of pits, so much for working it and getting the mineral to the surface,—so much for getting the mineral to the market, and against all these the price obtained for the mineral sold—these would be the elements of a profit and loss account of an entire adventure of this nature. But is this the sense in which the word 'profit' is used in the Act? I think not.
>
> *The intention of the Act, it is abundantly clear, was in Schedule A to tax 'property.'*"

After speaking of a tax on a trade or business under Schedule D, *Lord Penzance* continued:

> "But when such matter as that is brought under the provisions of this Act for taxation, the wide difference between

it and the present case is at once apparent; for the merchant or trader is taxed in such a case not in respect of any 'property' which he possesses, and of which he enjoys the fruits, but only upon the profits which he realizes annually in his trade; *whereas the owner of a 'mine' is taxed in respect of that 'mine' as a fixed and realized 'property'* which belongs to him, and from which he reaps an annual benefit; and the words 'annual value' or 'profit received' from that 'property,' are introduced into the statute, ***not*** *as the subject of taxation*, but only as *the measure of the taxation* to which the '*property*' shall be subjected."

Lord Blackburn referred to a previous case, and said:

"It was said by Lord Cairns in *Gowan v. Christy*, 3 Ex. D. 23, that a lease of mines 'is not in reality a lease at all in the sense of which we speak of agricultural leases. There is no fruit; that is to say, there is no sowing and reaping in the ordinary sense of the term, and there are no periodical harvests. What we call a mineral lease is really, when properly considered, a sale out and out of a portion of the mine.'

I think this is a perfectly accurate statement. But the argument that no income tax should be imposed on what is, perhaps not quite accurately, called rent reserved on a mineral lease, *because it is a payment by instalments of the price of minerals forming part of the land*, any more than on the price paid down in one sum for the out and out purchase of the minerals forming part of the land, is, I think, untenable."

Lord Blackburn then pointed out that under Schedule A the tax was upon *property*, and reviewed the previous legislation which had always taxed the proceeds of mines, and held that this long continued practice indicated a presumable intent to continue the taxation of mine proceeds.

The corporation excise tax is not a property tax, as this Court has specifically declared, nor has there been any federal legislation to control the interpretation of the law.

The English Act was again under consideration in *Alianza Company v. Bell*, 73 Law Journal (K. B.) 755. In that case an English Company owned caliche, or nitrate, beds in South

America. It was claimed that the company was assessable under Schedule D and that, in ascertaining the profits under that schedule, the actual cost of the materials worked up into the finished product should be deducted from the sales price.

Channel J.:—"In this country it is quite clear that the mine owner pays upon what he gets out of the mine, less, of course, the current expenses of getting it, but without any allowance for the original cost price to him of the mine, and without any regard to the fact that he is exhausting the source of income and that it may come to an end next year. * * *

Now in the case of properties abroad, *Schedule D* and not Schedule A applies. It is said, and with a certain amount of plausibility and quite accurately, in my view, as to certain concerns, that the profits or gains of a concern which obtains its money by selling articles, cannot be ascertained unless the cost price of the raw material which produces those articles which are so sold, is taken into account. As a general proposition that is, of course, absolutely correct. * * *

Under Schedule D there are certain rules by which the profits are to be ascertained, and, as I have already said, it may be that those are conventional rules for ascertaining a sum which the Income Tax Act of 1842 calls profits, but which really is not, in the proper sense, profits; * * * but still, for the purpose of the Income Tax, the conventional rule would have to be followed."

The Court then turns to the mine in question, and says:

"If an adventure deals with a particular deposit like a seam of coal or a bed of brick earth, and if the concern or company whose business or adventure is being assessed is a company to work out that deposit and turn it into money, *then it is the capital of that business. The bed of stuff is bought with their capital and is capital.* It is capital with which they are going to carry on the business, which is the turning of that into a profitable commodity, and selling the profitable commodity. * * *

The rule is that no allowance must be made in respect of capital. * * * There is not to be any allowance 'for any sum employed or intended to be employed as capital in such trade, manufacture, adventure or concern' (rule 3). * * * Where a company works a mine, it seems to me that the mine or stock of ore, or whatever is in it, is its capital, with which it starts, and no deduction for

> diminution of capital can be allowed. * * *
> The ground of my decision is that in the particular company with which I am dealing this is an exhaustion of capital, and that exhaustion of capital is not a subject for which deduction can be made *under the Income Tax Act.*"

Upon that ground the case was affirmed in the Court of Appeals in 74 Law Journal (K. B.), 219, and in the House of Lords, 75 Law Journal (K. B.), 44.

The corporation excise tax law contains no provisions similar to rule 3 of Schedule D. The unusual meaning given "profits" in the English Act can have no bearing upon the meaning of "net income" in the Act of August 5, 1909. On the other hand, our law distinctly provides for deduction on account of diminution or exhaustion of wasting capital.

> *Stratton's Independence, Limited, v. Howbert,* 231 U. S., 399, 417-18, 421.

The petitioner then quotes from the case of *Denniston v. Haddock,* 200 Pa. State, 426, to the effect that an instrument affecting ore lands will be construed like any other contract —by its own terms. This principle may be conceded. There is nothing in the case itself which seems helpful to the Government's contention, nor do we understand that they so claim. Its facts and decision have no bearing on the present inquiry and the case does not question or overrule the long line of decisions in that State holding that mineral deposits constitute a part of the real estate and are to be considered as corpus and not income.

> *Caldwell v. Fulton,* 31 Pa., 475.
> *Harlan v. Lehigh C. & N. Co.,* 35 Pa. St., 287.
> *Tiley v. Moyers,* 43 Pa. St., 404.
> *Stoughton's Appeal,* 88 Pa. St., 198.
> *Scranton v. Phillips,* 94 Pa. St., 15.
> *Eley's Appeal,* 103 Pa. St., 300.
> *Sanderson v. City of Scranton,* 105 Pa. St., 469.
> *Delaware, etc., R. R. Co. v. Sanderson,* 1 At. Rep., 394.
> *Hope's Appeal,* 3 At. Rep., 23.

Fairchild v. Fairchild, 9 At. Rep., 255.
Kingsley v. Hillsdale Iron Co., 144 Pa. St., 613.
Plumber v. Hillsdale Iron Co., 160 Pa. St., 483.
Blakely v. Marshall, 174 Pa. St., 425.
Hosack v. Crill, 204 Pa. St., 97.
Barnsdall v. Bradford Gas Co., 225 Pa. St., 338.

In the last named case the Court said:

> "The lessee is granted the possession of the land with the sole and exclusive right to mine and remove the minerals therein. In such a case, while the tenant is regarded as a lessee, *yet by the agreement he obtains title to the minerals.* * * * As also said in the *Duke case*, 107 Pa. St., 57, the whole of the oil, or only a part, may be taken under the lease; but whatever shall be taken is of the substance of the realty. * * * It will be observed that the lessee has not simply the right to the possession of the premises, but also the *title* to the oil, or such part thereof as he may be able to remove during his tenancy."

This case was followed without discussion in *Citizens' Gas Co. v. Whitney*, 232 Pa. St. 592.

Whatever name may be applied to an instrument, it is patent that, if title to real property be transferred thereunder, it is tantamount to a sale, for a sale is a contract, founded on a money consideration, by which the absolute or general property in the subject-matter is transferred from the seller to the buyer.

24 *Am. & Eng. Ency. of Law*, 1022, and cases cited in Note 1.

The authorities cited by petitioner on pages 11 and 12 of his brief do not support his contention that royalties paid for ore taken out under mining contracts constitute income. Let us look at some of them.

United States v. Gratiot, 14 Pet., 526.

Suit was brought by the United States on a bond given to insure the performance of a contract under which the United States gave the defendant permission to purchase lead ore "*from*

persons authorized to work the same," at the United States lead mines on the Upper Mississippi, in what is now the State of Illinois; to smelt such ore; to use sufficient fuel for carrying on the smelting business; and to cultivate enough land to furnish defendant's teams with provender. In return the defendant was to pay the United States six pounds of lead for every one hundred pounds smelted. The lands were public lands and the contract was made before Illinois was organized as a State.

The President had statutory power to lease these particular lead mines, and the question was certified whether he had power to make such a contract as was here involved. The court held that the contract in question constituted a lease within the President's statutory power, it being a contract for the possession of lands for carrying on smelting operations, for cutting fuel, and for cultivating for fodder.

It will be noted that the contract did not purport to dispose of any ore, but simply authorized the defendant to purchase ore from those who had already secured the right to work the mines, and to use such portions of the public land as might be necessary to carry on smelting operations and to raise fodder for animals, with the further right to cut and use needful fuel. The case therefore, does not involve the question whether the contract was a conveyance or a lease of ore in place, and certainly is not "decisive of the question," as claimed.

Hyatt v. Vincennes Bank, 113 U. S., 408.

All the mineral in a described tract was conveyed for 50 years, with the right to mine, construct necessary buildings, roads, etc., in return for specified royalties. The interest of the lessees in this contract, together with their fixtures on the land, was sold under a judicial sale conducted under the Indiana statutory requirements for the sale of real estate.

As stated by *Mr. Justice Blatchford*:

"The only question for decision is, by the stipulation

of the parties, whether the property in question should have been sold in the manner in which personal property was required by the statute of Indiana to be sold."

It was held that the lessee's interest in the land was a chattel real, which the Indiana statutes provided should be sold as real estate, the opinion concluding by the statement that it is not "intended to decide anything as to the *status* of the property, aside from the lawfulness of the manner of its sale."

Tenn. Oil Company v. Brown, 131 Fed., 696 (C. C. A. 6th Circuit).

This was a suit to remove a cloud from plaintiff's title, who claimed by conveyance from one Slaven under whom defendants also claimed the mineral interests in the land.

It seemed that Slaven, in consideration of $1.00, made an instrument selling and conveying to the defendants all the coal and other minerals, and all timber suitable for lumber, on a certain tract. The agreement required the grantee to explore for minerals and to mine them if found in sufficient quantities, paying therefor a royalty. There was no provision as to the duration of the agreement, nor when the grantee should commence mining operations. The grantee also had the right to terminate the agreement at any time. The grantee made no explorations for 15 years and Slaven thereupon conveyed the premises to the plaintiffs.

Held, that the agreement was a lease, not a conveyance, and, being terminable at the will of grantee, the grantor could also terminate it at any time. The Court, after stating that the intention of the parties governs, says that the real consideration was not the $1.00, but the thought that the mines would be explored and worked, and emphasizes the injustice that would be occasioned by holding the instrument to be a conveyance and thus giving the grantee the power to tie up the entire tract for an indefinite period in return for the $1.00 payment.

Lacey v. Newcomb, 95 Iowa, 287.

This agreement gave the exclusive right to mine coal; to use five acres of the surface for buildings; to build railroads upon and flow water over the surface, and provided a royalty for coal mined, not to fall below a certain amount per year, which should be payable as rental.

The lessee became insolvent and the lessor brought action to enforce a lien for unpaid royalties under a statute giving the landlord a lien for rent.

Held, that he was entitled to a lien upon funds in the hands of the assignee in insolvency derived from sale of insolvent's cars, railroads, etc., on the leased land.

The case goes on the theory that there was a lease of the surface and that the instrument, as regards both surface and coal, would be regarded as a lease within the benefit of the lien statute. It will be noted that one consideration was named for both surface and mineral rights which the court could not apportion, and, therefore, the lien had to be given for all or none of the amount due, and that the parties themselves designated the royalty payments as rental.

The Iowa Court has since made clear that they regard mineral deposits, or payments therefor, as corpus of the real estate, in

Hook v. Garfield Coal Company, 112 Ia., 210.

A testator's will provided:

> "I give and bequeath unto my wife, Mary T. Trash, all of my property both real and personal, and mixed, of whatever kind and wherever situated, to have and to hold as long as she may live, and to use the same for her support in any manner she chooses except she is not to sell any of the real estate I may die possessed of."

During her lifetime the widow leased certain of the land for coal mining purposes, she to receive a royalty of 10 cents per ton and the question arose as to whether she had the right

so to dispose of it. The court said:

> "The will clearly devised a life estate to Mary T. Trash. True, she had the right to use the land for her support in any manner she saw fit, but she was expressly denied the right to make a sale. The execution of the mining lease was a sale of property. The coal underneath the surface was a part of the real estate and the lease thereof, in the form in which it was executed was a transfer thereof. *Caldwell v. Fulton,* 31 Pa. State 475; Appeal of Duff, 14 At. 364; *Railway Company v. Sanderson,* 109 Pa. State, 585. * * * At that time [date of testator's death], the land was not being used for mining purposes, and there is nothing to indicate that testator intended it should be so used by the life tenant. Moreover, the will expressly negatives the idea."

Comley v. Ford, 65 W. Va., 429.

The plaintiff had granted defendant's assignor the right for 12 years to mine all coal under a certain tract and to take all necessary and convenient means for doing so, in return for which minimum royalties were to be paid. An unsealed instrument attempted to convey the lessee's interest to defendant. Defendant did not mine any coal and suit was brought against him for the minimum royalties, the defense being that there was no privity of either estate or contract between plaintiff and defendant. The defense was sustained, since defendant neither went into possession nor made any contract with the plaintiff. In regard to the assignment from the original lessee to the defendant, it appeared that, under the W. Va. statutes, no interest in lands for a period of over five years can be conveyed except by will or deed. The attempted assignment, in this case, was by an unsealed instrument which, in West Virginia, does not constitute a deed.

The doctrine that royalty payments are part of the real estate, and not income, has, however, been established in West Virginia.

Wilson v. Youst, 43 W. Va., 826.

Held, that an oil lease giving the lessee the right to remove all the oil on certain premises, in consideration of giving the lessors a certain per cent thereof, is, in legal effect, a sale of a portion of the land, and that the income derived from royalties paid under the lease goes to the life tenant, while the royalties, themselves, as corpus, go to the remainder men.

After stating that the life tenant had no right to work the oil deposit, because it had not been opened at the testator's death, the court said:

> "Oil in place under the land, as we have seen, has been held in this State to be a part of the realty and as much so as timber, coal, iron ore or salt; that it is a part of the inheritance, and an unlawful removal thereof is a disherison of him in remainder constituting waste, which a court of equity, in a proper case, will enjoin and restrain."

And in *Selvey v. Grafton Coal Co.*, 72 W. Va., 680, the Court held there was no material variance between an allegation that the plaintiffs owned certain land and proof that the plaintiffs had coal mining rights therein under an ordinary mining lease.

Gartside v. Outley, 58 Ill., 210, (cited by petitioner) is also irrelevant. After making a mortgage upon certain premises, the mortgagor executed a mining lease thereof, authorizing the lessee to mine and remove coal under the land. A breach of conditions having occurred warranting a foreclosure of the mortgage, the court held that "the foreclosure of mortgages, "and the sale thereunder, would terminate absolutely and "forever all rights of the grantee [under the lease] and his "assigns," whether the mining contract be regarded as a lease or as "conveying a higher estate."

Manning v. Frazier, 96 Ill., 279, is, however, quite in point. Where a land owner granted the coal in a tract of land at a

stipulated price per ton for the coal removed, payable quarterly, the Supreme Court said:

> "The fair and reasonable construction of the instrument, we think, is that it was a sale and conveyance of the coal in the mine on credit, and to be paid at stated intervals after coal was removed, and that the amount of each of these quarterly payments was left indefinite, and the amount to be ascertained by computation from the number of tons removed during the previous three months, at the sum named for each ton. The time for the payments to be made was not definitely fixed and the amount of each payment was left contingent, depending upon the amount removed during each period, but the money thus to be paid was purchase money for the conveyance of the coal, stone and ore."

The petitioner also cites *Austin v. Coal & Manufacturing Co.*, 72 Mo. 535. It appeared that a coal mining company took an agreement from the owner of certain land, in consideration of the fixed annual rental of $400.00, leasing and conveying to it for a term of years all the coal under the land. The company never took possession of, or entered upon, the land, and became insolvent. Some years later the defendant went upon the land and mined coal therefrom, and, when sued for the trespass by the land owner, alleged that it had settled therefor with the lessee, and pleaded such settlement as a bar, on the ground that the mining lessee was the owner of the coal. The court held that the instrument was not an absolute grant of all the coal in the land, and that mere acceptance of the contract did not vest in the lessee the property in the coal.

Ganter v. Atkinson, 35 Wis., 48.

Plaintiffs, under an oral agreement with the owner, were given the right to mine lead ores on a certain tract of land. Held, that they had such an interest in the land that they might maintain an action of trespass against third persons for mining and removing ore therefrom.

A recollection of the common law as to the rights of life tenants and remaindermen in mines, is necessary in order properly to weigh some of the cases cited by petitioner in this connection.

A testator has power to give mine proceeds, irrespective of whether they be corpus or income, to either the life tenant or remainderman and, of course, where he expressly states his intent, it controls. Where there is no express declaration, the courts early adopted the rule that the testator presumably intended the life tenant to get such proceeds as were current in the testator's lifetime, and, therefore, the proceeds of mines open at testator's death were granted to the life tenant. The courts have included as "open" mines, those which the testator leased in his lifetime but were not actually worked until later, and also those which the testator has specifically directed or authorized his executors to open or to lease for mining purposes, it being held that these constitute "open" mines within the testator's contemplation.

In re Ridge, 31 Chancery Division, 504, 508 (1886),

Lord Justice Lindley said:

> "As between a tenant for life and remainder-man, money paid by a lessee as the price of land won or carried away and sold by the lessee in the shape of minerals, stones or bricks, is always treated as capital and not income, unless the settlor has expressed an intention to the contrary by making the tenant for life unimpeachable for waste, or by some other expression; or unless, at the time of the settlement, the mines and minerals let were open, in which case an intention to the contrary is inferred, unless such inference is inconsistent with the language of the settlement."

Whitfield v. Belit, 2 P. W. 242.

One seized in fee conveyed the lands and all trees and mines thereon to trustees in fee to the use of A. for life with remainder over.

Held, that A. cannot open the mines or cut the trees.

Ferrand v. Wilson, 4 Hare, 388, 15 Law Journal (Ch.), 41
Held, that a tenant in tail is entitled to moneys realized by a life tenant from stone not used for repairs, and mineral from newly opened mines.

See also *Maynard's Settled Estate,* 68 Law Journal (Chancery), 609 (1899).

Howes, in The American Law Relating to Income and Principal, pages 5-6 and 7, thus states the law in this country on the subject:

> "A life tenant has no right to open new mines, quarries or wells on the land. If a trustee opens new mines, quarries or wells, the product or the rent or royalties are principal in the absence of any contrary intent on the part of the creator of the trust. He should invest such proceeds and pay the income to those entitled to the use, benefit or income of the estate" (Citing cases).
>
> "A tenant for life has the right to operate, for his own benefit, such mines, quarries or oil wells as were 'open' when he came into the estate, and he is entitled to the entire net proceeds. * * * Mines or wells are 'open' although the creator of the trust or life estate may not have been operating them himself. For example: If he had leased the land for oil purposes, stipulating for the delivery to him of a definite part of the oil produced, a bequest of the income of his estate would include these royalties. If the will or deed creating the life estate or trust shows an intention by testator or grantor that the land is to be used for mining, quarrying or oil purposes, the use and income will be taken to mean the entire net income without provision to repair waste, unless a contrary intention of the testator or grantor appears. The decisions on this point go wholly on the expressed or implied intention of the grantor or testator. *Eley's Appeal,* 103 Pa. State, 300 *McClintock v. Dana,* 106 Pa. State, 386; *In re Ridge,* 31 Chancery Divn., 504."

See also Note in 36 L. R. A. (N. S.), 1089, 1108.

It is significant that the courts, when free to exercise their own judgment, treat mine proceeds as corpus, and only give

them to the life tenant when, as *Lord Lindley* says, the testator expresses or implies such an intent.

The following cases cited in the Government brief involved "open" mines (as heretofore defined), and applied the common law rules mentioned above.

Raynolds v. Hanna, 55 Fed., 782 (Reversed on another ground, *Sub Nom. Brooks v. Raynolds,* in 59 Fed., 933).
Daly v. Beckett, 24 Beav., 114.
Hendrix v. McBeth, 61 Ind., 473.
Eley's Appeal, 103 Pa. St., 300.
McClintock v. Dana, 106 Pa. St., 386.
Shoemaker's Appeal, 106 Pa. St., 392.

In *McClintock v. Dana, supra,* the will of a testatrix left the income of the estate to an only daughter for life. The executors, under specific power given them in the will, leased certain coal mines on a royalty basis, and the daughter was held entitled to these royalties. The Court said:

> "The question here involved, as in *Eley's Appeal,* is to be determined according to the intent of the testatrix; the daughter's rights are commensurate with that intention, which, being established, the technical character of the rental becomes unimportant. * * * The authority to lease or sell the coal, which was vested, by the will, in the trustees and was exercised by them, so far as the present inquiry is concerned, places the rights of the *cestui que trust* upon the same footing as if that power had been exercised by the testatrix in her lifetime. What was done under authority of the will is to be considered as if done by the testatrix herself. If the instrument of writing here styled a lease, had been executed by Sarah H. Woodbury [testatrix] in her life time and the mines had been in operation under it at her death, her intention, as expressed in her will, could not be mistaken."

Tennessee Oil, Gas & Mineral Co. v. Brown, 131 Fed., 696,

is so palpably irrelevant and distinguishable, upon mere inspection, that it requires no comment.

There was no sugggestion in the opinion of the Circuit Court of Appeals in these cases that a mining lease constituted an absolute and immediate passing of title to the ores to the lessee, —a sale and transfer *in praesenti*. The nature of the transaction demonstrates the absurdity of any such contention. Such instruments, however, are analogous to executory contracts of sale and the rights and obligations of the parties thereunder are practically similar to rights and obligations arising and attaching under such contracts.

This is precisely recognized and enforced in the cases of,

Genet v. D. & H. Canal Co., 136 N. Y., 593, and
Browning v. Boswell, 215 Fed., 826, cited by petitioner.

To the same effect is,

Kansas Natural Gas Co. v. Board, 75 Kan., 335.

The name of "leases," commonly given to these mining contracts for convenience, is by no means conclusive as to the nature of the moneys paid thereunder. At the time of its execution it is immaterial, alike to the fee owner and the would-be miner, what their agreement may be called. Their common purpose is to enable the latter to enter upon the described premises and to extract and own the ores there existing, upon certain agreed terms. The rights, liabilities and limitations of each party are particularly set forth in the contract. It does not evidence any intention to effect a present, absolute sale of the ores and an immediate and irrevocable transfer of title thereto, but, as between the miner and the fee owner, the transaction secures to him, *at the time of the execution of the agreements*, the right (irrevocable as respects the fee owner) to secure absolute ownership of the ores, and, when he has mined and removed them in accordance with the terms of the contract, a completed sale results and the title to the ore is fixed in the miner, while the money paid for the ores becomes its purchase price in the hands of the owner. Just so are transactions under the common option contracts for the purchase and sale of land. If, and when,

the optionee elects to perform the obligations imposed upon him and to take over the land, the title to the same vests equitably in him, and when the purchase money is paid, and the proper conveyance is executed and delivered by the vendor, and placed of record, the legal title passes. If the vendor decline to carry out his contract, the vendee may maintain a suit to enforce its specific performance. The name applied to the instrument is in no wise controlling; its effect is determined by the intention of the parties expressed therein, to be effectuated in accordance with the terms of their contract.

So here we are not required to discuss what may be the proper technical designation of these mining contracts; we need only interpret them to learn the purposes of the parties, and, if those are clear, to ascertain their effect. The contracts being thus read, it is obvious that the moneys paid by the "lessee" (or vendee of the ore) are intended to be in payment for the ore, in accordance with its agreed valuation. By the removal of and payment for the ore, the property therein passes from the fee owner to the vendee. When received by the fee owner, this payment represents to him the property which he has relinquished to his vendee, and the money stands as assets in lieu of the ore which has passed. When the ore is exhausted, his principal remains in the form of the money into which it has been converted. In so far as it does not exceed the value of the ore at the time of the incidence of the tax, it is *capital;* to the extent to which it may exceed such value, it may be classed as *gross income.*

It is clear, then, that the Circuit Court of Appeals based its decision upon the correct principle when it declared in the cases at bar that the assets transferred to the land companies at the time of their organization consisted in the rights to collect the moneys payable under the outstanding contracts, regardless of whether those contracts be called options, contracts of sale or mining leases.

While we regard the discussion of this subject as unnecessary for a proper determination of the questions presented in these cases,—it being evident that the mining contracts constitute property, and create property rights often of great value—it has seemed desirable, in the light of the insistence of the petitioner, to consider the matter thus fully.

B. *The case of State v. Evans,* 99 Minn., 220.—The nature and effect of this decision are sufficiently disclosed by the comment of *Judge Sanborn* at page 150 of the record in these cases.

C. *The Evans case as a rule of property.*—But it is urged by petitioner that the decision established a rule of property binding upon this and all other Federal Courts. There is absolutely no basis for the assertion, and none of the cases cited in its support tend to sustain it. They are the following:

Bucher v. Railroad Company, 125 U. S., 555.

An action was brought in the United States Circuit Court, District of Massachusetts, to recover damages for injuries received by plaintiff while traveling on a defective highway on Sunday. A Massachusetts statute prohibited Sunday traveling, except on works of charity and necessity, and the State Supreme Court had held that one traveling on a highway for other purposes, on Sunday, could not recover damages for personal injuries. The Federal Court held that this decision, construing a law of local character, would be observed and followed and would, therefore, prevent a recovery by plaintiff, in the United States Court.

Clarke v. Clarke, 178 U. S., 186.

A will was probated in South Carolina, whose Supreme Court held that the decedent's real estate had become equitably converted into personal property at his death. Some of the real estate was located in Connecticut, whose Supreme Court

held that there had been no conversion, and a writ of error was sued out on the theory that the Connecticut Court had failed to give full faith and credit to the South Carolina decision.

Held, that Connecticut was not bound to follow the South Carolina decision, but was its own judge as to the descent of real estate within its borders.

Abraham v. Casey, 179 U. S., 210.

This court said:

> "These conclusions of the State court depended alone upon an interpretation of the local law of the State governing sales, the record of the title to real estate and the nature under the local law of the rights of the mortgagee creditor. * * * It is the duty of this court to follow the rule announced on such subjects by the highest court of the State. *Clarke v. Clarke,* 178 U. S. 186."

East Central Company v. Central Eureka Co., 204 U. S., 266.

The plaintiff prevailed in the State courts in California in a suit to quiet title. The defendant had claimed under a quit-claim deed from the plaintiff which granted part of the land under which lay the mineral deposit in dispute. The California court had held that the quit-claim deed did not purport to convey the ore under the surface.

This court said:

> "The construction and effect of the conveyance between private parties is a matter as to which we follow the court of the State."

Kuhn v. Fairmont Coal Co., 215 U. S., 349.

The Supreme Court of West Virginia held, in another action, that a lessee of coal lands was under no implied duty to leave in place sufficient coal to support the surface.

The *Kuhn case* was instituted in Federal court shortly before this decision (which was the first of its kind), was rendered and the question was certified to this court, whether

the Federal court was bound by the *subsequent State decision.* This question was answered in the negative.

Foster v. Elk Ford Oil & Gas Co., 90 Fed., 178.

It was held that the Federal court in this case would follow state decisions of West Virginia, establishing rules affecting real property in the State.

York v. Washburn, 129 Fed., 564.

In Minnesota oral leases for more than one year are within the statute of frauds, and the Minnesota decisions construing the statute were followed to the effect that an oral contract for a lease of land in that State, though unenforcible, is not void —hence that the lessee cannot recover earnest money paid thereon,—the lessor being able and willing to perform.

Fretts v. Shriber, 181 Fed., 279.

Held, that a decision by the State court that an instrument is an option and not a contract of sale, while not binding on the Federal court when rendered subsequent to the time the instant case arose, will, nevertheless, be followed when the Federal court is in doubt.

All the above cases concerned private disputes in most instances governed by local laws or rules of property, and in none of them was the construction of a Federal statute involved. They have no application here.

The cases at bar not only involve an interpretation of a Federal law, but the law in question is a taxing law which under the Constitution must operate with uniformity to be valid. Yet it is urged that the excise tax which it seeks to impose shall be collectible in Minnesota by reason of a decision rendered by the State court in an action having no connection whatever with the Federal Act or with the subject of taxation, while, by the same reasoning, the tax could not be imposed in Illinois, or

Iowa, or West Virginia or Pennsylvania.

No argument beyond the statement of the contention is required for its refutation.

It is obviously essential that the Federal courts shall exercise an independent judgment in construing a Federal statute, uninfluenced by the views of any State court, to the end that the statute may be uniform in its application.

The rule may be generally stated as follows:

In reference to the doctrines of commercial law and general jurisprudence, the interpretation of the common law, and the construction and application of the Federal Constitution and Federal statutes, and the determination of matters of Federal concern, the United States courts will exercise independent judgment, although they will regard with the hightest respect decisions of the State courts on these subjects and, where the question seems to be balanced with doubt, will lean toward an agreement of views with the State courts; but where the construction of State Constitutions or statutes is concerned, in matters of local law and procedure, and in cases involving local rules of property and of contract, or of State public policy, the Federal courts will be governed by the law of a State as expressed in its Constitution or statutes, or declared by its highest court.

Swift v. Tyson, 16 Peters, 1.
Olcott v. Fond Du Lac Co., 16 Wall., 678.
Hough v. Texas & Pacific Ry. Co., 100 U. S., 213.
Burgess v. Seligman, 107 U. S., 20.
Clark v. Bever, 139 U. S., 96.
Hartford Fire Ins. Co. v. C. M. & St. P. R. R. Co., 175 U. S., 91.
Calhoun Gold Mining Co. v. Ajax Gold Mining Co., 182 U. S., 499.

In *Olcott v. Supervisors, supra*, a case involving the validity of county obligations issued for the construction of a railway in Wisconsin, *Mr Justice Strong* said:

"It is undoubtedly true in general that this court often follows the decisions of the highest courts of the States respecting local questions peculiar to themselves, or respecting the construction of their own constitutions and laws. But it must be kept in mind that it is only decisions upon local questions, those which are peculiar to the several States, or adjudications upon the meaning of the constitution or statutes of a State, which the Federal courts adopt as rules for their own judgments. * * * Now, whether a use is public or private is not a question of constitutional construction. It is a question of general law. It has as much reference to the constitution of any other State as it has to the State of Wisconsin. Its solution must be sought not in the decisions of any single State tribunal, but in general principles common to all courts. The nature of taxation, what uses are public and what are private, and the extent of unrestricted legislative power, are matters which, like questions of commercial law, no State court can conclusively determine for us."

The case of *Hartford Fire Insurance Co. v. C., M. & St. P. Ry. Co., supra,* brought up the question of the public policy of the State of Iowa. *Mr. Justice Gray,* delivering the opinion of this court, referred to the fact that it was settled doctrine that a provision in a contract between a railroad corporation and the owner of goods received by it as a common carrier that it was not to be liable to him for loss or injury caused by the negligence of itself or its servants, is contrary to public policy. He added that such a provision "must be held to be void in the "courts of the United States, without regard to the decisions "of the courts of the State in which the question arises. But "the reasons on which those decisions are founded are, that "such a question is one of general mercantile law; that the lia- "bility of a common carrier is created by the common law, "and not by contract"; and that, therefore, the Federal courts must be free to pass upon such matters uninfluenced by decisions of local tribunals. He then added (page 100):

"Questions of public policy as affecting the liability for acts done, or upon contracts made and to be performed, within one of the States of the Union,—when not control-

> led by the Constitution, laws or treaties of the United States, or by the principles of the commercial or mercantile law, or of general jurisprudence of national or universal application—are governed by the law of the state as expressed in its own Constitution and statutes, or declared by its highest court."

Calhoun Company v. Ajax Company, supra, was a controversy between owners of intersecting ore veins in the State of Colorado, whose rights depended upon the construction of the Federal mining statutes.

The plaintiff in error claimed that the Colorado Supreme Court had given the statute a construction favorable to him, which became a rule of property prior to the location of his vein, and that the present reversal of the rule would take away what he regarded as a vested right.

This Court said:

> "There are serious objections to accepting that consequence as determinative of our judgment. We might, by doing so, confirm titles in Colorado, but we might disturb them elsewhere. The statute construed is a Federal one, being a law, not only for Colorado, but for all of the mining States, and, therefore, a rule for all, not a rule for one, must be declared. * * * It may be that the repose of titles in the State was best effected by a reversal of the prior cases. At any rate, a Federal statute has more than a local application, and, until construed by this court, cannot be said to have an established meaning. The necessity of this is illustrated, if it needs illustration, from the different view taken of sections 2322 and 2336 in California, Arizona and Montana from that taken in the prior Colorado cases. * * * Manifestly on account of this difference, if for no other, this court must interpret the sections independently of local considerations."

No decision of the Supreme Court of Minnesota, or of any other State, can, consequently, control the interpretation to be placed by this court upon a tax law which must operate uniformly in every part of the United States.

We will now turn to the important question under this division of the case, and inquire

What Composes Gross Income?

In the decision announced by *Judge Willard* in the District Court, the meaning of the words *gross income*, as employed in the Act of August 5th, 1909, was carefully considered. He regarded the most important question in the case to be whether or not the sums of money which were received by the companies, during the years for which they were taxed, were gross income within the meaning of the act (page 118).

At page 119 we find this statement:

> "I do not base my decision upon the meaning of that word [depreciation] nor upon its use in the act, but rather upon the meaning which should be given to the words *gross income*. Those are the words used in the act, together with the words 'net income' and 'earnings.' The words 'gross receipts' were not used in this act, as they are in the case of *Spreckles Sugar Refining Co. v. McLain*, 192 U. S. 397, nor are the words used here 'deposits,' as was the word used in *Society for Savings v. Coite*, 6 Wall. 594. What was intended by the use of the words gross income? What does the word income mean? In ordinary speech people recognize the difference between capital and income. I believe that the ordinary meaning attached to income, when it is not derived from personal exertion, is that it is something produced by capital without impairing that capital and which leaves the property intact, and that nothing can be called income for the purpose of this act which takes away from the property itself. If it does, then it ceases to be income, and amounts to a sale of capital assets. * * * It necessarily follows from the views which I have expressed, that the words 'gross income' do not mean 'gross receipts.' It is apparent to me that gross income cannot mean gross receipts. * * * *It is perfectly apparent from the language of the act, that it was never the intention of Congress to impose a tax upon a corporation that was not making money; it was never its intention to tax a losing business*" (page 120).

The sentence last quoted presents an unanswerable argument against the contention of the petitioner here, that *gross receipts* and *gross income* mean the same thing under the Act of 1909. It cannot be assumed that the petitioner will insist that the Act of 1909 contemplated the imposition of an excise tax upon a corporation doing a losing business. The only rational interpretation of the law is that, unless a corporation organized for profit and engaged in business shall produce net profits in excess of $5,000.00 per year, it shall not be subject to the tax.

Flint v. Stone-Tracy Co., 220 U. S., 145.

It is, of course, perfectly clear that an owner of land, valuable only for its mineral content, and embraced in a mining contract which he has made authorizing his grantee or lessee to mine and remove all of the ore in consideration of the payment of a stated amount per ton, has, if the grantee or lessee retain and perform the contract until the exhaustion of the ore deposit, *no property right of value in the land except the right to demand and receive such royalties;* and when the ore is exhausted the value of his estate in the land is also exhausted.

If such owner desire, through pressure of necessity or otherwise, to realize, before the exhaustion of the ore, a present lump sum for such estate, he may do so by a conveyance of the title to the land, subject to the outstanding contracts, to any purchaser he may procure.

Now is it conceivable that, in such a case (and instances of such sales of leased property are not unknown), the seller will be required to pay a tax upon the entire amount received by him, upon the theory that such moneys constitute income? And is it conceivable that the royalty payments made to the purchaser from year to year, under the contracts, are not in law, as they are in fact only a conversion into money of the investment which he has made in the land, and is, therefore, a

mere return to him of his capital?

If we are right in this, then the receipts of the respondent companies do not constitute gross income, but are simply a conversion and return of invested capital.

Judge Willard further said:

> "That this ore in place is capital, and is part of the real estate, I think admits of no question. It is just as much a part of the real estate as trees standing on the land. Let us suppose that John S. Pillsbury & Co., when it owned this land with the timber still standing thereon, was a corporation; that in 1908 it sold the timber with the privilege of removing it within ten years, and that in 1909, 1910 and 1911 the purchaser cut the timber and during these years paid the purchase price of it. Could it be said that the purchase price so received was income within the meaning of this Act? I do not think that it could. It was not income, it was the property itself, and, as I said before, the trees standing on the land were no more part of the realty than is the ore under the surface of the land. They are both capital, and money derived from the sale thereof cannot be considered income, whether it be money received from ore, or money received from the timber (page 121)."

And again:

> "This case is to be decided upon what the actual facts are, and not upon what they appear to be. The actual facts are that nobody has made a dollar out of these properties by these incorporations. The evidence shows that the same persons own the stock who owned the property before the corporations were organized. The mere change of form of ownership from that of these individuals to that of a corporation owned by the same individuals, cannot produce such large profits as are claimed here. The only conclusion that I can come to on this branch of the case is, that this money was never received as gross income, and cannot be in any sense called income; that it was never taxable and that the tax on it was unlawfully collected" (pages 123-4).

In the opinion filed in these cases by the Circuit Court of Appeals, the distinction between income and proceeds of the conversion of invested capital is shown with equal clearness and logical conviction. Thus at page 147:

> "That the word *income* in this Act is not synonymous with the word *receipts*, and that it does not include receipts from the conversion without gain or profit of any part of the property of the corporation into money, or into any other form, is demonstrated by the fact that this word income appears in the clause 'the gross amount of the income of such corporation' and segregates and designates a specific part and not all of the receipts of a corporation as the basis of the measure of the tax; by the fact that only those expenses paid out of income, none of those paid out of capital or property, are to be deducted; by the fact that a deduction for depreciation of property is to be made; by the evident purpose and the whole tenor of the Act. *This word 'income' is used throughout the statute in contra-distinction to property or invested capital, and it was neither the intention of the Congress, nor is it the legal effect of the Act, to impose any tax on account of the amounts received by a corporation that is not engaged in the business of buying, selling or trading in property, from the conversion of its property without gain into money or into any other form.* These corporations were never engaged in any such business. And it is not doubtful that the small amounts of money received by them from the sales of the lots and lands that were conveyed to them at their organization in 1907 were not income, but were mere proceeds of parts of their property on account of which they could not lawfully be taxed."

Can the accuracy of the statement above quoted be denied, that, in the Act of 1909, "this word income is used throughout the statute in contra-distinction to property or invested capital"? Nevertheless, *the whole contention of the Government in these cases rests upon a denial of that statement.* The tax imposed by the Commissioner was computed upon the theory that *the entire gross receipts of the respondents in each year constituted gross income*, and that the amount thereof, after deducting merely taxes and expenses paid in each year, respectively, was the net income by which the excise tax should be measured. That this position of the Commissioner was deemed accurate by the United States Attorney who tried the cases below is evidenced by the requests for declarations of law submitted by him as follows:

I.

"That the royalties paid to and received by the plaintiffs under and pursuant to the several mining leases referred to in the evidence, constitute and are gross income within the spirit and meaning of the corporation tax law approved August 5th, 1909.

II.

"That the Commissioner of Internal Revenue was authorized by said Act of Congress to assess against the plaintiffs the taxes mentioned in the complaints herein upon the royalties paid to the plaintiffs for the years 1909, 1910 and 1911.

III.

"That the defendant is entitled to judgment for the taxes collected under and pursuant to the assessment made by the Commissioner of Internal Revenue, being the same taxes to recover which these actions were instituted" (page 113).

Manifestly, if the attitude of the Commissioner and of the United States Attorney is correct and the respondents were taxable under the Act of 1909 upon their entire gross receipts, which, as demonstrated in the opinion of the Circuit Court of Appeals, embraced the entire value of the properties conveyed to the respondents, there is *no* distinction to be made under the Act of 1909 between "income" and "property or invested capital."

We quote further from the opinion of the Circuit Court of Appeals:

"But were the royalties which had been owing to these corporations by the lessees since 1906 and which these corporations collected and received in 1909, 1910 and 1911, as they fell due, income by the amount of which the taxes upon them must be measured under the tax act, or were they the mere proceeds of the conversion without gain or profit of parts of their property into money, and no part of the

measure of their lawful tax? The lands, and hence the property, of the corporations had no substantial value without the rights to collect the royalties the lessees had covenanted to pay. The leases had been made by the former owners prior to 1907 and, if there was any gain, profit or income from the making of the leases, that income accrued years before the tax act took effect, and the corporations are exempt from any taxation on account of it. * * * In 1906 and 1907 these corporations took from the lessors the latter's claims and rights to collect and receive from the lessees the royalties they had covenanted to pay for the ore, and the title to the lands, and issued their stock therefor. If there was any gain, profit or income in this transaction, it was made in 1906 and 1907, at least two years before January 1st, 1909, when the tax took effect, and the corporations are exempt from taxation on account of the income" (pages 147-148).

"If the purchase price of the ores, called royalties in the lease, ever became income, *it must have been when the leases were made.* But the truth is that the leases merely changed the form of the property of the lessors from ores to the rights and claims to the purchase price of the ores which the lessees covenanted to pay under the name of royalties, and the receipts by the corporations of the payments of parts of those claims which fell due in 1909, 1910 and 1911, were but another substitution of the cash received for the parts of the claims paid" (page 150).

At page 151, adverting to the circumstances leading up to the incorporation of the respondents, and their particular purpose of providing a practicable mode of partition of the undivided interests of the stockholders, the opinion of the Circuit Court of Appeals continues:

"Any one of these owners had the equitable right to such a partition. If one or more of them had petitioned the proper Court for such relief and the Court had appointed a receiver or master to collect the claims for the purchase price of the ore, or royalties, and to convert the property into money and distribute it among the owners according to their respective interests, could any Court lawfully have held that the proceeds thus obtained were the gain, profit or income of the equitable owners? These corporations stood in the same relation to the claims for the purchase price of the ore, or the royalties and the moneys they collected from them, and to the equitable owners of the prop-

erty, their stockholders, that such a receiver would have stood. In reality they received and held these claims and the moneys collected from them in trust to distribute them among the equitable owners of the property, and the moneys they have collected were no more the income of the corporations or of their stockholders than is any part of the claims that are not collected from any other part of their property. Those collections were simply another form of the property of the corporations, and of the stockholders, substituted for the parts of the claims paid. The considerations which have now been stated have convinced that there was no error in the decision of the Court below that the moneys collected by the corporations in 1909, 1910 and 1911, under the mining leases, on the claims for the royalties on, or the purchase price of, the ore, were not either gross or net income within the meaning of the tax act; and that corporations that were, when the corporation tax act took effect on January 1st, 1909, the owners of claims purchased years earlier for royalties on ores under mining leases made by their grantors,—whereby the absolute right to dig and have all the ore in the lands leased, which without the ore were worthless, and to remove it at any time during terms so long as to be equivalent to an unlimited time, was granted to the lessees, and they covenanted to pay therefor yearly fixed amounts per ton for the ore extracted and minimum amounts yearly to be credited on ore subsequently removed, in case sufficient to come to the minimum was not extracted in any year,—are not taxable on account of the amounts coming due and received by the corporations in partial payment of those claims during the years 1909, 1910 and 1911, where their property was formerly owned and was conveyed to them by their original stockholders, and the sole purpose of the conveyance and of their organization was to enable them to collect these claims, to convert the property conveyed to them into money, and to divide the proceeds among their stockholders."

The manner of conversion and partition of the various properties owned by the Pillsbury heirs and Messrs. Longyear and Bennett necessarily depended upon the respective natures thereof. It is not denied that properties which have no value except for the iron deposits thereon, must be disposed of in the one usual and accepted manner in which iron ore is sold, to-wit: by so-called "mining leases" (pages 95-6; Decision of

Circuit Court of Appeals, pages 144-5). Properties which may be non-mineral and have value for agricultural purposes are properly disposed of by sales in tracts of such areas as the demands of the locality will permit. Properties which are saleable in the form of village lots are justifiably disposed of in that form. By the vesting of all the undivided interests in one corporation it was enabled to handle them in these ways.

During the entire time comprehended in the controversy here presented, all proceeds received by the respondents out of the conversion of their properties in any manner were immediately distributed to their stockholders, and no portion was at any time retained for the speculative purchase of other properties, or for investment for the common profit and benefit of the corporate members. The capital of each corporation has always been represented only by the property conveyed to it at the time of its organization; it was not capable of producing gain by natural increase or more profitable disposition, and it has not been added to or turned over by purchases and sales, or in any form of business transaction, either with a view to profit or otherwise, but, on the contrary, has been steadily diminished and distributed as opportunity to liquidate and partition the assets has presented.

As observed by *Judge Willard*, the Act carefully employs the word "income," with reference to both gross income and net income, and not the word "receipts."

By the use of the term "gross amount of the income," it is apparent that Congress could not have meant "gross receipts." Had it intended so unusual and important a scheme as to tax *gross receipts*, it would have used language appropriate to that end. The distinction between *gross income* and *gross receipts* is so well understood that it must be accepted that, if Congress had meant the latter, it would have said so, just as it said it in the Act of June 13, 1898, which imposed a tax based upon "the

gross annual *receipts* of any corporation or company carrying on or doing the business of refining sugar." In that instance Congress designed to tax gross receipts, and it said gross receipts. (See *Spreckles Sugar Co. v. McClain*, 192 U. S., 397). It must be presumed that Congress employed the words "gross income" in their commonly-understood meaning, which, beyond question, excludes the proceeds of converted capital, and differentiates them from "gross receipts."

In the ordinary significance of the term "income" it means profits, earnings, gains or increase, and not receipts.

Thus one derives income from payment of interest upon a bond, but, when a bond matures and is paid off with the last interest payment, the *principal* received is never considered as income, although it is distinctly an item of cash receipts, and would so be entered on the owner's books.

The same is true of a mortgage debt, the interest accruing thereon alone being considered as income.

If real or personal property be sold under a contract permitting payment of the purchase price in instalments extending over a period of time, with provisions for annual or semi-annual interest on deferred payments, such interest only is entered to the account of income. The various instalments of principal as paid are never so regarded, but are placed to the account of capital investment, and are not chargeable with income tax.

Foley v. Fletcher, 3 H. & N., 769.

The royalty payments received by the respondents were simply such instalments of purchase price of the ores taken under the mining contracts.

Various Definitions of "Income".

While the whole scheme of the Act of 1909, as its text so clearly indicates, makes a pronounced distinction between *income* and *capital* and, with meticulous care, excludes the latter from the measure of the excise tax, we append a few definitions of "income" as cumulative evidence of the purpose of the legislation.

In *Black on Income Tax*, section 32, we find this definition:

> "'Income' is defined as that gain which proceeds from labor, business, property or capital of any kind, as the produce of a farm, the rent of houses, the proceeds of professional business, the profits of commerce or of occupation, or the interest of money or stock in funds, etc.; revenue, salary, especially the annual receipts of a private person or a corporation from property. It means that which comes into or is received from any business or investment of capital without reference to the outgoing expenditures. * * * But, on the other hand, in a statute imposing taxes, 'income' means gross receipts, not net profits, *unless it is so specified. Whenever the law means to tax the clear profits arising from the employment of capital or otherwise, the expression used is 'net income' or 'net annual income'* * * *
>
> *We conclude, therefore, that for the purpose of an income tax a proper definition of the word 'income' would be, all that a man receives in cash during the year, except such sums as are merely capital or principal in a changed form; that is, excluding sums which are merely the proceeds of some other form of capital converted into cash.*"

In section 34, *Mr. Black* continues:

> "Both in popular and legal parlance 'income' is distinguished from 'capital' or 'principal.' Capital is the source of income. Income is the fruit of capital. Capital may be made very mobile and constantly change from one form of investment to another. Each time that it returns to the owner, it may or may not bring income with it, but it would be a misnomer to reckon the whole of such return as 'income' simply because it is so much money coming into the possession of the owner. *Out of the fund so returning there must first be deducted, in case there has been no loss, a*

sum sufficient to replace the capital originally invested, and the balance, if any, will be income. Thus when money is loaned on a promissory note for one year at interest, and the note is paid at maturity, with the accumulated interest, the sum received must be proportioned between capital and interest. The receipt of so much of that sum as equals the face of the note is not a receipt of income; it is a replacement or substitution of capital; only the money received as interest constitutes income. * * * Again, a sum of money received from a railroad company in payment of damages for a part of a person's land taken by the railroad for its use is not income; it is a substituted capital."

Mr. Seligman, in his treatise entitled "The Income Tax," says:

"Section 5: The meaning of income. At the outset of such a study it is desirable to secure a clear idea of what is meant by income. Income is, of course, to be distinguished from mere receipts or gross revenue. * * * By income is always meant net income as opposed to gross income. In other words, from the receipts of any enterprise we must, in the first place, deduct the expenses of the enterprise—that is, the outlay incurred in securing the gross product. * * * Income, therefore, always means net income. * * * What has been stated is equivalent to saying that income is that which comes to an individual above all necessary expenses of acquisition, and which is available for his own consumption. Since the income is a flow of wealth it must always be estimated for a definite period, so that, when we speak of income for the purposes of taxation, we really mean annual income. Strictly speaking, income as contrasted with capital denotes the amount of wealth which flows in during a definite period and which is at the disposal of the owner for purposes of consumption, *so that in consuming it his capital remains unimpaired.*"

The Supreme Court of Georgia, in *Mundy v. Van Hoose,* 104 Ga., 625, emphasizes the distinction between capital and income, saying:

"Income, as defined by Mr. Webster, is that gain which proceeds from labor, business, property, or capital of any kind—as the produce of a farm, the rent of houses, the proceeds of professional business, the profits of commerce or occupation, or the interest of money or stock in funds, etc. *The definition demonstrates the distinction between capital*

assets and the income which they produce; the latter is the profits, product or gain derived from the use or investment of the former."

In *Spooner v. Phillips*, 62 Conn. 262, the court said:

> "The word income has a broader meaning [than dividends], *but hardly broad enough to include things not separated in some way from the principal.* It is not synonomous with 'increase.' The value of stock may be increased by good management, prospects of business, and the like, but such increase is not income. It may also be increased by an accumulation of surplus; but so long as that surplus is retained by the corporation either as surplus or increased stock, it can in no proper sense be called 'income.'"

In *Stratton's Independence, Ltd., v. Howbert*, 231 U. S., at page 415, *Mr. Justice Pitney* says:

> "For 'income' may be defined as gain derived from capital or labor, or from both combined."

This definition was approved in

> *Connecticut General Life Ins. Co. v. Eaton*, 218 Fed., 188, 205.

In *Wilcox v. County Commissioners*, 103 Mass., 544, under a statute of Massachusetts imposing a tax upon "income from profession, trade or employment exceeding $1,000," income was defined as follows:

> "The income from a 'profession, trade or employment,' which is taxable under our system of laws, *is an entirely different thing from the capital invested in the business or the stock of goods, in the purchase of which the whole or any part of such capital may have been expended.* The income meant by the statute is the income for the year, and is the result of the year's business. It is the net result of many combined influences; the use of the capital invested; the personal labor and services of the members of the firm; the skill and ability with which they lay in, or from time to time renew, their stock; the carefulness and good judgment with which they sell and give credit; and the foresight and address with which they hold themselves prepared for the fluctuations and contingencies affecting the

> general commerce and business of the country. To express it in a more summary and comprehensive form, it [income] is the *creation* of capital, industry and skill."

If income is not skill, or industry, or *capital;* if it is something created by and out of capital, and is in its essence an entirely different thing from capital invested, it is something that is acquired and possessed *in addition to* the capital.

In the opinion filed by *Judge Sessions* in *Mitchell Bros. Co. v. Doyle,* 225 Fed., 437, it is said:

> "*In each instance income is and must be something over and above the original capital investment plus the cost of production and sale.* This rule has been uniformly recognized by the Commissioner of Internal Revenue in the decisions and directions issued from his office for the guidance of the collectors of corporate excise taxes and of the taxpayers themselves."

In the same case, an appeal, not yet reported, *Judge Denison* said:

> "*It is clear that by the term 'income' Congress did not intend to include the proceeds of capital assets sold or converted during the year; nor can it be material whether such proceeds are re-invested in other property or remain in the treasury of the company, or are distributed to the stockholders;* nor whether, in case of such distribution, they are called dividends or capital. The controlling question must be whether assets so converted are, in fact, *at the beginning of the tax period,* properly to be classed as capital assets. If they are of that character they cannot be 'income' received during the later period; they represent merely capital in the changed form. * * * Indeed, no one disputes the proposition, in its broadest aspect, that the selling price of capital assets is not 'income.' "

From "*The American Law Relating to Income and Principal,*" by Edwin A. Howes, Jr., we take the following excerpts:

> "Income of property consists of the proceeds of what the property *produces,* the profit which comes from its use in business, or what is paid for its use by another than its owner. Principal, or capital, is the property itself" (page 1).

"The owner of a mine is likely to consider the product of the mine as income. It is not real income, but is part of the property itself. Although timber is a real product of the land, the production of it covers so long a period that a life tenant, or a trustee for a life beneficiary, cannot ordinarily treat it as income, because the taking of it strips the land of something which cannot be replaced while the life interest lasts" (page 2).

"The products of mines, quarries or oil wells are really not products, but part of the land itself, which once used cannot be replaced. Such products, therefore, do not come within the strict, narrow meaning of the word income" (page 5).

If one of the stockholders of the respondent corporations had died in January, 1909, how would his estate have been valued for the purposes of inheritance taxation? Would a contention that the proportionate part of the corporation assets (consisting almost wholly of the moneys payable under the mining contracts) represented by his stock was of no capital value, because all of the royalties receivable thereunder would be income and not principal, be acquiesced in by the taxing officials or be sustained by the Courts? Would not rather, the value of the stock, as computed from a valuation of the payments receivable under the mining contracts, be the first and controlling inquiry?

If an individual owned, on January 1, 1909, a tenth of the capital stock of the respondent corporations, and nothing else, would he be said to have no invested capital? And if his stock represented invested capital, when that capital was returned to him in the form of royalty payments, would it not, as being capital, be free from income taxation?

Proceeds of Sales of Capital Assets are Not Income.

As respects pecuniary returns from investments in any kind of property, it may therefore, be accurately asserted that *income is that part of the net receipts of a tax payer which repre-*

sents gains or profits after returning to him the full value of his principal investment, from the use, disposition or transmutation of which the gain or profit results.

The case of *Stevens v. Hudson's Bay Company,* 101 L. T. Rep., 96 (reported also in 5 Tax Cases, 424), is an interesting and instructive illustration of the approval and application of this principle.

The company kept accounts of land sales separate from the accounts of its trading department. Such accounts showed that in 1903, in addition to profits from trading, the company received £177,000 from land sales. The surveyor of taxes insisted that the company was liable to taxation on this sum as being profits or gains in trade. The company claimed that the moneys were not taxable; that they represented part of the capital value of land acquired by the company under its original charter of 1670, being reserved to the company under an act of 1868, whereby, in consideration of £300,000 paid in money, and the right to select from time to time one-twentieth of the fertile lands resigned by it, there were surrendered to the Dominion of Canada the lands held under the original charter, and the privileges and rights of the "Governor and Company of Adventurers of England trading into Hudson Bay." Under this arrangement, the company had selected lands at different times, and had sold portions thereof to persons willing to buy, and the sums in question represented the net amount derived from such sales during the year 1903. These moneys, and others, were applied in reducing the capital of the company by £2 per share.

Channell, J., decided that the money was taxable as income and the company appealed. The decision was reversed.

The *Master of the Rolls*, after reciting the above facts said (at page 97):

> "I need not stay to observe that, if the money is otherwise liable to income tax, it cannot escape taxation by rea-

son of its being applied to a capital purpose.

"The real question is whether this money can be regarded as profits or gains derived by the company from carrying on a trade or business. In my opinion it cannot. The company was doing no more than an ordinary land owner does who is minded to sell from time to time, as purchasers offer, portions, suitable for building, of an estate which has devolved upon him from his ancestors. I am unable to attach any weight to the circumstance that large sales were made every year. This is not a case where land is, from time to time, purchased with a view of re-sale; the company are only getting rid by sale as fast as they reasonably can of land which they acquired as part of a consideration for the surrender of their charter. Channell, J., has treated it as a conclusion of law from the facts stated in the case, that the company were carrying on the trade of selling land. With great respect to the learned judge, I am unable to accept this view."

The statement of the Master of the Rolls is eminently true of the owners of iron properties who do not carry on mining operations, but who are only getting rid of their ore as fast as they reasonably can by selling it under so-called mining leases for a fixed royalty price.

In the same case, *Farwell, L. J., said* (pages 97-8):

"*It is well settled that income, not capital, is taxable under the income tax acts.* * * * Income is not the less income for the purposes of income tax because it is produced by embarking capital in a wasting subject matter—e. g., in buying and working mines; *nor, on the other hand, does an annual sum become income merely because it is paid annually. If it be in its inception, and not by adjustment and subsequent recoupment, composed partly of capital and partly of income, then the tax is chargeable only on so much as is income.** * * The actual claim by the Crown in the present case is extravagant, for it is for the whole of the purchase money. If the company were to be treated as trading, they must at least be allowed the price paid for the land—namely, a proportionate part of the value of the area conveyed by them to the Canadian Government, less 300,000£. paid."

Another instructive case is found in

Secretary of State for India v. Scoble, 89 L. T. Rep., 1.

Under a contract made with a railway company, the Indian Government had power to purchase its railway, and it was agreed that the purchase money might, upon notice, be paid in the form of an "annuity" for a term of years. The purchase was afterward made by the government, which elected to pay the price in half-yearly instalments for forty-nine years. The Secretary of State for India deducted an income tax on the full amount of the first two payments, and Scoble and others sued to recover the sums so withheld.

It was decided that the payments were not annuities or annual payments within the meaning of the acts imposing a tax "for and in respect of all profits arising from interest, annuities, dividends, and shares of annuities payable out of any public revenue."

Lord Halsbury, giving judgment, said (at page 3):

> "*Was it the intention of the income tax acts ever to tax capital as if it was income? I think it cannot be done, both upon the language of the Act itself, and upon the whole import and meaning of the income tax acts, and that it never was intended to tax capital, at all events as income.* * * * And I cannot disagree with what all the three learned judges of the Court of Appeals pointed out, that you start upon the inquiry into the matter with the fact of *an antecedent debt which has got to be paid; and if these sums, which it cannot be denied are partly in liquidation of that debt which is due, are to be taxed as if they were income in each year in which the payment is being exacted, the result is that you are taxing part of the capital.*"

A more exact definition of the situation in the present cases cannot be conceived. The moneys received by the respondent companies under the respective mining contracts were part of "an antecedent debt which has got to be paid;" and those sums which, as in the English case, it cannot be denied were paid in liquidation of that debt as it became due, were a part of the

capital of the corporations. An excise tax laid with reference thereto, is one based upon capital and not upon income.

In *Baldwin Locomotive Works v. McCoach*, 215 Fed., 967, 969, the following interesting analysis of the Act of 1909 was made by Judge Dickinson, whose decision allowing a recovery of an excise tax unlawfully exacted from the plaintiff was affirmed by the Circuit Court of Appeals for the Third Circuit, in 229 Fed., 59:

> "The first observation called forth by the act of Congress is that Congress has declared its will upon three points: First, that the amount of the tax shall be based upon the 'net income' received by the taxpayer within the year. Secondly, that this 'net income' shall be determined by finding first the 'gross income' and then taking from this amount certain specified deductions. Thirdly, no deductions, with one exception, shall be made unless the amounts to be deducted were *paid out of income* within the year, and no income is to be considered unless it was income *received within the year*. The general purpose is, first, to have the amount of the 'net income' received during the year determine the amount of the tax.
>
> The second observation to be made is, the choice of terms which Congress has made. The amount of the tax might have been made to turn upon the 'net gains, profits, increase and income,' or upon the amount or value of the 'net assets' of the taxpayer, or upon the 'increase in the net assets.' Congress has seen fit to confine itself to the 'net income' alone. * * * A like choice of words is to be discovered in the part of the Act which enumerates what shall be deducted from the 'gross income.' The 'ordinary and necessary' expenses, the 'losses,' the 'taxes,' etc., are all to be determined by what the corporation has actually *'paid.'* It is not 'expenses and losses' which have been properly 'incurred,' or taxes which have been lawfully 'assessed,' but the amount which has been 'paid' is made the criterion. The deduction of a reasonable allowance for 'depreciation,' which is permitted also to be made from the amount of gross income, is not out of harmony with this general test of 'payment.' It is the case of the exception proving the rule, because this allowance, not being for actual payment, would not be justified were it not expressly mentioned."

From the foregoing, two principles are made clear: One, that the income which is made the measure of the tax is *annual net income received between specific dates twelve months apart;* the other, that income or other property received before the beginning of any such period is not taxable therein. Applying those principles to the present case, it will be found that

The Properties Owned by the Respondent Corporations on January 1, 1909, were Capital at that Date.

The incidence of the corporation excise tax was fixed by the Act as of January 1, 1909. Therefore, the calculation must date as from that time.

It is wholly immaterial whether a corporation received an income, large or small, made profits or incurred losses, in any year or years before 1909; the only important inquiry as to 1909, or any year thereafter, is, *What was the gross income for that year?*

Income received before that date neither required nor permitted the imposition of an excise tax for 1909 any more than income received after December 31st, 1909.

Bailey v. New York Cent. R. R. Co., 106 U. S., 109.
Lynch v. Turrish (decided Sept. 4, 1916, C. C. A., 8th Circuit), not yet reported.

Undoubtedly, the value of the corporate assets of the respondents was exactly the same on December 31st, 1909, as it was on January 2nd, 1907, when the last of the mining contracts was made, except as it had been reduced by payments meanwhile made under the contracts. The right to collect for every ton of ore on the lands of the companies was limited to the stipulated price named in the contracts, and admitted of no increase by way of advance in valuation. *If, then, the value of the corporate assets was unchangeably established before January 1, 1909, so that the corporation could neither gain*

nor lose a dollar on account of them in any subsequent year, and all its transactions consisted only in receiving for its stockholders, in any tax year, the value so fixed of the assets transmuted into cash in such year, it is manifest that there could result no gross income. If the corporation retained in its treasury all its cash receipts, it would be no richer than it was on January 1, 1909; but it would be poorer by the sum of its taxes and expenses paid out of such annual receipts.

To this effect was the decision filed in the United States District Court for the Western District of Michigan in the case of

Mitchell Bros. Co. v. Doyle, 225 Fed., 437.

It appeared that in 1903 a lumber company acquired certain timber properties which were thereafter carried upon the books of the company at the cost price; but by December 31, 1908, the properties had increased in value at the rate of $20.00 per acre. In its excise tax returns for the years 1909 to 1912, the company deducted from the gross receipts for timber converted into lumber and for cut-over lands which were sold by it—as being a return or conversion of capital assets—amounts which were admittedly the fair market value of such timber and land on the first day of January, 1909. The Commissioner of Internal Revenue declined to accept such return and allowed, as a deduction from the gross receipts for each year only the original cost in 1903 of the timber and lands sold, and assessed against the corporation an additional excise tax upon the difference between the cost in 1903 and the admitted value on January 1, 1909, upon the theory that any difference in value above the cost was *income for the year in which the property was sold.* The additional taxes thus assessed were paid under protest and suit was brought to recover them, judgment being entered in favor of the corporation for the sum claimed.

Touching the question under discussion, *District Judge Sessions* observed, at page 439:

"The plaintiff claims that its standing timber and other property were capital assets, and that the portion of the proceeds derived from the cutting, manufacture, and sale of such timber, measured by the actual stumpage value thereof, did not constitute income, and therefore that, in computing its taxable net income, it was entitled to deduct such actual stumpage value of its timber from its gross receipts. The Commissioner of Internal Revenue concedes the right of the plaintiff to deduct the original cost price of the timber, as shown by its books, from its gross receipts, but denies its right to make any deduction on account of increase in values. The Attorney General contends that *all* the proceeds derived from the manufacture and sale of the timber constituted income, and that plaintiff, in its return of taxable net income, had no right to make any deductions whatsoever, on account of either cost price or actual value of the timber stumpage.

"The proofs in this case show conclusively that, between the time of their purchase in 1903 and the 1st day of January, 1909, when the Excise Tax Law became effective, plaintiff's timber, lands, and other property had so increased in value that they were fully worth the amounts which were deducted from gross receipts as capital assets. It cannot be denied that the plaintiff's standing timber was a part of its capital assets, and that the conversion of the timber into lumber and the sale of the lumber constituted at least an indirect sale of the timber, and so of capital assets. The mere change of the timber into lumber or money did not transform capital into income. The miller who grinds his stock of wheat into flour and sells the flour does not thereby destroy or impair his capital and convert it into income. The same is true of the manufacturer who converts his cotton into cloth, the landowner who sells his lands for cash, the furniture maker who transforms lumber and other material into chairs and tables, the ironmaker who produces steel rails from iron ore, and every industrial institution where raw materials are converted into finished or other products, or into money. In each instance *income is and must be something over and above the original capital investment plus the cost of production and sale.* This rule has been uniformly recognized by the Commissioner of Internal Revenue in the decisions and directions issued from his office for the guidance of the collectors of corporation excise taxes and of the taxpayers themselves. * * *

"If plaintiff had sold its standing timber on the first day

of January, 1909, at its market value, could it be claimed that any part of the proceeds of such sale constituted taxable income, because more was realized than the original cost in 1903? Certainly not, for the reason that the increase in value had occurred prior to the time when the excise tax law became operative. If plaintiff had purchased this timber 30 years ago, from the Government at $1.25 per acre, and had manufactured all of it into lumber and sold the lumber during the year 1909 at market prices which prevailed on the first day of that year, could it be claimed that the entire proceeds of the lumber above the trifling purchase price of the timber and the cost of manufacture and sale constituted taxable net income? Can the Government, at least in the absence of specific legislative declaration to that effect, reach back years before the enactment of this revenue statute for the controlling factor in determining the net income of a corporation? *Can it ignore a substantial increase in value of property, which has occurred and accrued prior to the taking effect of the tax law and thereby convert into income that which is not income within any meaning of the term?* To state these questions is to answer them."

"The rule of apportionment of the increment or increase of values between the years prior to January 1st, 1909, and those subsequent to that time, which has been recognized and acted upon by the Commissioner of Internal Revenue, does not aid the Government in this case, for the reason that the amounts deducted by plaintiff from its gross receipts as capital assets do not exceed the actual market value of its property on January 1st, 1909."

This case was taken to the Circuit Court of Appeals for the Sixth Circuit, where, in an opinion filed June 30, 1916, but not yet reported, which affirmed the judgment of the District Court, we find this language:

"If the property on hand at the end of the year, figured at its true inventory or market value, must be put upon one side of the income account, there can be no escape from putting the corresponding true value at the beginning of the year upon the other side of the account; and this must include raw materials which were on hand at the beginning. The law contemplates distinct periods. *Everything before 1909 must be in one period;* everything later, in another; and then, for taxing purposes, each calendar year after that date forms a distinct sub-period; the law

plainly contemplates that all income shall be definitely located somewhere. The law applied to and took effect upon business conducted after January 1, 1909; business is conducted with property; and so *the law took effect upon the body of the property existing at that date and upon the business thereafter conducted by and with the aid of that body of property.* In the later successive years, and as to some classes of property, it may serve every purpose to delay the computation or entry of income or gains seemingly existing in one year until cash realization in the next, and to do this by carrying an arbitrary but constnat inventory value; this will make no difference to the taxpayer or to the Government in the end; but not so with reference to the two main periods before and after the law took effect. In the sense in which we have seen 'income' is and must be used at the end of each taxing year, it must be used at the end of the period preceding 1909. * * * The true character of that particular accumulation on January 1, 1909, now involved, may be illustrated with reference to this corporation. To meet this $20.00 per acre increase in market value the company could lawfully have paid out a cash dividend, or a stock dividend, or it could have sold its property for the original value plus the appreciation and have distributed the entire proceeds. If this had been done on December 31, 1908, there would be no income in 1909. If the consummation were postponed for two days, upon no tenable theory could it be thought that the $20.00 appreciation would become part of the income produced by carrying on the business during 1909. We are satisfied that the necessary and practical working of the law requires, and that its words fairly permit, income for one year to be computed by the aid of comparison between the market value of the body of property on hand at the beginning and at the end of the year; and *it follows that such a market value of property existing at the commencement of the period, must be deducted from the selling price afterward received.*"

The respondents in the cases at bar had, on the first day of January, 1909, all the property which they will ever have, and that property was then valued at the full amount which they will ever receive for it. Since that date, their only receipts have been the proceeds of its disposition. Their mining contracts were a part of their invested capital and no income there-

from has been received, or, in the circumstances, has been possible. Each of the respondents owns property of the same precise value as attached to it on the first day of January, 1909, less the amount which has been received since from conversion of portions of it from real estate, or *quasi* real estate, into a cash equivalent which has been distributed, as already stated, to its stockholders.

If, instead of receiving cash for the ore taken under the contracts, the respondents had received for it lands, or other property than cash, the situation would be no different; yet, of course, the Government would not claim that in such case the value of the lands or other property must be included as gross income in the corporation tax returns.

The case of

Forty Fort Coal Company v. Kirkendall, 233 Fed., 704,

is directly in point.

In that case the coal company was required to pay corporation excise taxes upon the full value of the coal mined by it, upon the theory advanced by the defendant, as Collector of Internal Revenue, that such value represented income, whereas the coal in place was of the value of 15c per ton. Having paid the taxes the Company sued to recover the amount and secured a judgment by default. Upon an application by the defendant to vacate the judgment, *Judge Witmer* said, in respect of this question:

> "The Act of Congress requires the allowance for depreciation of property in reasonable amount. It is not denied in the petition to set aside that the plaintiff's property was depleted to the amount of 15c for each ton of coal mined. * * * It requires no argument to demonstrate that, under the tax law which makes an allowance for depletion or depreciation, if an owner has a ton of coal in the ground worth 15 cents, and he digs it up and sells it for 15 cents, *the amount so received for it is not income, but is, in fact, only a return to him of the value of his coal as part of his capital asset.*"

Thus far in this litigation the petitioner and his counsel have frankly conceded that mineral, as it lies in the ground is *capital.* No one will deny that. As far as the respondents are concerned that capital has been bargained away to others in consideration of specific payments to be periodically made, *and the obligations of such grantees of the ore to make the stated payments represent the existing capital of the Land Companies.* Whether that capital be in the form of ore or of promises to pay, it necessarily remains capital, as to them, and was such when the excise law went into effect.

During the years 1909 to 1911, the income, if any, derived from the mines accrued to their grantees; for the respondents did not extract the ore; they did not smelt it; they did not sell it; they did not realize any gain out of it; they carried on no business in respect of it. If there were income derived from the operation of the properties, the tax based thereon has been paid, presumably, by the operators.

It follows very plainly that any income in the way of gains or profits from the disposition of capital assets or their use in business, must be computed upon the basis of the value of such resources on the first day of January, 1909, since that date marks the beginning of the taxing period for which a computation of income must be made and for which only a tax can be imposed.

This was demonstrated both by *Judge Willard* and by *Judge Sanborn.*

Thus, at pages 122-3 of the transcript, in the course of his decision in the District Court, *Judge Willard* said, with reference to the corporate assets of the respondents:

> "The Commissioner seems to have made an attempt to apply to the case that part of the regulations heretofore quoted under the heading 'Sale of capital assets.' This property was all acquired prior to January 1, 1909. In applying the rule, it is necessary for him to determine the proportion of the gain which arose *subsequent to that*

date. There is no evidence to show what the value of this property was at any time before the incorporation, or at any time since. *Yet it clearly appears that there has been no gain at all, so far as these plaintiffs are concerned, since 1909.* All of the leases were made prior to that date for terms of fifty years or more. *The value of the property to the plaintiffs was then fixed and it could not be changed to their advantage during the terms of the leases.* In other words, the property was worth no more to them in 1909, 1910 and 1911 than it was in 1906, 1907 and 1908. * * * This case is to be decided upon what the actual facts are, and not upon what they appear to be. The actual facts are that nobody has made a dollar out of these properties by these incorporations."

We now quote from *Judge Sanborn*:

"In 1906 and 1907 these corporations took from the lessors the latters' claims and rights to collect and received from the lessees the royalties they had covenanted to pay for the ore, and the title to the lands, and issued their stock therefor. *If there was any gain, profit or income in this transaction, it was made in 1906 and 1907, at least two years before January 1, 1909, when the Tax Act took effect,* and the corporations were exempt from taxation on account of that income. *Merchants Ins. Co. v. McCartney,* 17 Fed., Cases No. 9443, page 46. On January 1, 1909, when the Act took effect, and for years before that date, these corporations were the owners of the claims and rights to collect and receive the amounts which the lessees had covenanted by the leases to pay for the ore in the lands, and of the lands themselves. *These things were their absolute property on January 1, 1909, and none of them was any part of their subsequent income, gain or profit.* The land was practically worthless; the rights and claims to collect the amounts the lessees had covenanted to pay for the ores were practically all there was of value in their property, and these were worth hundreds of thousands of dollars. If they had sold these claims in 1909 for cash for their actual value, for no more and no less than their actual value, *no part of that cash could have been gain, profit or income. It could not have escaped being a mere different form of their property, of their capital, and the corporations could not have been taxable on account of it"* (pages 147-8).

The conclusion thus adduced cannot be escaped. Suppose a person to be the owner, on the 31st day of December, 1908, of mineral bearing property containing a million tons of merchantable iron ore, which may have cost him, ten years before, $50,000, but which possessed a value in place, on December 31, 1908, of $250,000.00. Regardless of the original cost to him, the owner manifestly has in that property, on that day, an asset equal to the sum last named. Can the fact of the enactment of the Corporation Excise Tax Law in August, 1909, destroy that pre-existing estate? Had Congress the power, after December 31st, 1908, validly to declare that only one-fifth of it is capital, because that is all that it cost, and that the other four-fifths are income?

Suppose, again, that the owner of the property sold the same in January, 1909, for its full value of $250,000.00, which was paid in cash, and that the money was at once invested by the seller in bank stocks; can the Congress say to him thereafter, "Only one-fifth of your bank stock is capital, and the remaining four-fifths are to be deemed and taxed as income"? Yet, is the $250,000.00 any the less invested principal when in the mine than it is in the form of bank stocks? Further, can there be any question but that, in the hands of its *purchaser* in January, 1909, the mine would represent capital and nothing else? If the mine had an intrinsic value of $250,000.00, at the moment of the sale, and it is a capital investment of the purchaser in that amount, must it not necessarily have been a capital investment of the *seller* in the same amount, at the moment of the sale?

In the cases at bar the respondents are, in fact, *the purchasers*. They bought the properties in July, 1906, at their then value, and paid for them by the issuance of their capital stock, and that value has never increased since, *because it was fixed at a specific sum by the terms of the mining contracts.*

All judicial decisions have recognized and applied the rule

for which we now contend, namely, that *that is capital which is owned by a taxpayer at the time of the incidence of the tax, and that, to the extent of its value at that time, money into which the property is afterward converted, is not to be considered as income which can form the basis of taxation.*

C. B. & Q. Ry. Co. v. Page, 1 Biss., 461 (Fed. Cases No. 2668);
Reynolds v. Williams, 4 Biss., 108 (Fed. Cases No. 11734);
United States v. Smith, 1 Sawyer, 277 (Fed. Cases No. 16341);
Merchants' Insurance Co. v. McCartney, 1 Lowell, 447 (Fed. Cases No. 9443);
Gray v. Darlington, 82 U. S., 63;
Bailey v. Railroad Company, 106 U. S., 109.
Mitchell Bros. Co. v. Doyle, 225 Fed., 437;
Same case, on appeal, C. C. A., 6th Circuit, not yet reported.
Lynch v. Turrish, C. C. A., 8th Circuit, not yet reported.
Lynch v. Hornby, C. C. A., 8th Circuit, not yet reported.

Merchants Insurance Co. v. McCartney arose under the Income Tax Law of 1864. The company being a stockholder in a bank received a dividend from the bank, three-tenths of which was made up out of profits accumulated before the passage of the Income Tax Law of 1864; upon the remaining seven-tenths the bank had paid the Internal Revenue tax. The defendant, United States Collector, exacted from the plaintiff payment of the tax of five per cent upon the whole sum received, which payment was made under protest and an action brought to recover it. By the Act of 1864, a tax of 5 per cent was imposed upon the net annual income or gains of such corporations; but a deduction was permitted of income derived from dividends on shares in banks, etc., the tax upon which had been paid by the corporations declaring the dividends. The plaintiff contended that no part of the dividends paid by the bank was liable to assessment because, as to the three-tenths, it was not income, and as to the seven-tenths the tax had already been

paid by the bank. *Judge Lowell,* in sustaining this contention, said:

> "As to the three-tenths it seems to me to have been *a division of capital, a return to the plaintiffs in money of a part of the property which was already in their ownership as capital stock when the first tax act was passed.* If the Suffolk bank had been wholly wound up and had returned to its stockholders the exact value of their shares in money, *having made no profits since the passage of the original act,* this sum of money could not be taxed as income, gains or profits; and so of a part. If the plaintiffs on receiving the money chose to divide it among their own stockholders, still it is not a dividend out of gains and profits, nor out of the surplus funds, because the surplus funds that are taxable are those which are or have been made out of profits *since the passage of the act.*"

The case of *Bailey v. New York Central R. R. Co.*, 106 U S., 109, throws light upon our inquiry.

This case also arose under the Federal Income Tax Law of 1864, Section 122 of which provided:

> "That any railroad, canal, turnpike, canal navigation or slack-water company * * * that may have declared any dividend in scrip, or money due or payable to its stockholders, as part of the earnings, profits, income or gains of such company, and all profits of such company carried to the account of any fund or used for construction, shall be subject to and pay a duty of five per centum on the amount of all such interest, or coupons, dividends or profits whenever the same shall be payable."

The railway company had expended from its earnings in constructing and equipping its road and purchase of properties, an amount equal to eighty per cent of its capital stock, for which, by resolution of its Board of Directors, it was declared the stockholders were entitled to reimbursement at some convenient future period; to evidence such right certificates were thereupon issued to each stockholder declaring him entitled to receive out of future earnings, at the option of the company, eighty per cent of the amount of the capital stock held by him.

In 1870 an assessment of five per centum upon the amount of the certificates was made upon the company. The assessment was paid and suit brought to recover it. Upon the trial, the Circuit Judge charged the jury that, while the certificates constituted a scrip dividend which justified the assessment, nevertheless *it was competent for the company to show what amount of the earnings of the company, accrued since the existence of the tax law, was included in the certificates, and that this amount alone was subject to the tax.* The contention of the defendant, Collector of Internal Revenue, was, that the certificates were conclusive upon the railroad company as to the amount subject to taxation. The company recovered a judgment for the tax paid upon that part of the moneys represented by the certificates which it had earned prior to the taxing period, and this judgment was affirmed by the Supreme Court in an opinion delivered by *Mr. Justice Matthews,* in which this language occurred:

> "It should be borne in mind, in the first place, that the tax provided for in this section of the Act, is an *annual* income tax, and *its subject is the interest paid and profits earned by the company for each year, and year by year;* and that, both by the express letter of the law and its necessary implications, the tax is not laid on any of these funds *which came into being before the time prescribed in the Act.* And in the ordinary execution of the law, it was contemplated that the funds to be taxed and the tax imposed upon them would be concurrent, as to each fiscal year; the scheme of the statute being to levy the tax upon the income for the year ending on the 31st of December next preceding the assessment; and while it would be altogether admissible to go back for the purpose of assessing the tax upon a proper fund which had accrued during a previous year and escaped taxation, nevertheless, the tax imposed would be for the omitted year. But no tax, in contemplation of the law, accrues upon the fund except for the year in which the fund itself accrued. It is also to be remembered that the subject-matter of the tax is the net earnings of the company for the year for which they are taxed, which have been actually realized by it, or which the law assumes to have been."

In

Gauley Mountain Coal Co. v. Hayes, 230 Fed., 110 (C. C. A., 4th Circuit),

the court said, referring to the Act of 1909:

> "It is manifestly the purpose of this act to tax the net income for the year in which the assessment is made. The Supreme Court, in the case of *Gray v. Darlington,* 82 U. S., 63, passed on the precise question."

In the case of *United States v. Smith,* 1 Sawyer, 277 (7 Fed. Cases, No. 16341), the defendant was indicted for the crime of perjury in making a false income return for the year 1868. In that year he sold certain stocks but returned no portion of the selling price over and above the original cost, as income. In charging the jury, the Court stated that the income tax law then in force related back to the original Act of August 5, 1861, and added that:

> "—the defendant was bound to state and return for taxation as income, all gains and profits derived from the sale of stocks in 1868, whenever purchased, *so that they were purchased since August 5, 1861.*"

In other words, the value of properties existing prior to the enactment or effective date of an Income Tax Law, is the basis from which subsequent income therefrom must be ascertained.

Likewise in *C. B. & Q. R. R. Co. v. Page,* 1 Biss., 461 (Fed. Cases, No. 2668), the railroad company, prior to the tax law of July 1, 1862, had made advances to another corporation for which it had taken mortgages. After the passage of the law the mortgages were foreclosed and stock certificates were issued to the shareholders of the railroad company, representing their proportionate interest in the properties acquired under the foreclosure. It was held that the stock thus issued did not represent "dividends due and payable during the year 1862," which were made taxable by the law, *because the prop-*

erty represented thereby was capital of the corporation when the law went into effect, the Court saying:

> "These profits and earnings had then [July 1, 1862] actually been disbursed for them[the mortgages], *and they were held as a part of the general assets of the company.* * * * But the argument here is, that it is of no consequence what the actual value of the property was in November, 1862, or at the time of the advances,—though not one quarter of the money paid,—yet it must be regarded as a dividend for the whole.* * * It is plain that such a principle would reach every purchase made with its profits by the railway company in past years, either of real or personal property, added to the general stock, and any apportionment of stock so acquired, for which a certificate might be given after September 1st, 1862, showing the amount of such purchase or apportionment, and the share of the stockholder in the same. A construction which leads to such consequences ought not to be given to this statute unless the language imperatively demands it. * * * If in 1860 a man had bought an estate, or a mortgage on one, with a portion of his income for that year, he thereby added to his estate the value of the purchase. If he in that way increased his income for 1862, that would be taken into account in assessing it, but if he were then to foreclose the mortgage or perfect his title, that would only be consummating a right of property by enforcing an absolute lien. If he made sale of the property, would the proceeds become part of his income for that year, even though re-invested in another estate? * * * We think, therefore, under the circumstances of this case, these certificates of stock cannot be regarded as a dividend declared due and payable to the stockholders in November, 1862. *The company and the stockholders treated that part of the property acquired with these earnings as capital stock, and it cannot be at the same time stock added to the capital and a dividend.*"

Palpably, in the cases at bar, no corporate assets came into being after January 1, 1909, and nothing that can be called income was comprised in the moneys received by the respondents after that date. The companies and their stockholders treated their property interests under the mining contracts,—subsequently represented by the payments received during the

years in question—as capital assets. If those interests were not capital, then the corporation had no capital assets at any time; if they were capital assets when received in 1906, they were capital in 1909, 1910 and 1911 when they were liquidated by payment, and such payments constituted capital subject to reinvestment or to distribution among stockholders.

In *Reynolds v. Williams*, 4 Biss., 108 (Federal Cases, No. 11734), the facts before the Court showed that the Lafayette & Indianapolis R. R. Co. and the Indianapolis & Cincinnati R. R. Co. were duly consolidated under the laws of the State of Indiana so as to merge the two in a new corporation called the Indianapolis, Cincinnati & Lafayette R. R. Co. The plaintiff was appointed trustee of the Lafayette & Indianapolis R. R. Co. charged with the duty of adjusting its unsettled business. In that capacity he made a return of the receipts and expenditures of the company from the first of July, 1864, to the 30th day of June, 1866, the date at which it ceased to operate its road, and paid the income tax upon the net earnings of the company for that period. As a part of the consolidation arrangement, $100,000.00 of United States bonds which had been purchased by the company in July, 1863, out of previous net proceeds of operation, were held by the plaintiff as a trustee for the use of the stockholders. An income tax of five per centum, or $5,000.00, was assessed against these bonds, under the Act of 1867, as being gains, profits and income accrued to the beneficiaries in the year in which the trustee received the fund. Having paid the tax under protest, the plaintiff sued to recover it back.

The Court said:

> "It appears, then, that the one hundred thousand dollars of United States bonds was the property of the Lafayette and Indianapolis Railroad Company in the year 1863, and continued to belong to that company till its dissolution on the 8th day of January, 1867; and that on that day the plaintiff, as trustee, became, and ever since has

been, the legal owner of the bonds in question. * * * From what appears in the declaration, it is certain that the plaintiff, as a trustee, became the owner of these bonds on the 8th day of January, 1867. Before that time they were the property of the Lafayette and Indianapolis Railroad Company. On that day this company died, and by a sort of last will and testament, called in the declaration 'Articles of Consolidation' transferred the legal title to said bonds to the plaintiff as a trustee, and the equitable interest in them, as I construe the declaration, to the stockholders of said company. These bonds, so far as appears from the declaration, never were taxed in the hands of the company.

"I suppose that the 'gains, profits and income' mentioned in the act to which we have referred, are not to be regarded as an increase of the wealth of the trustee, but of the *cestui que trusts* for whom he receives and holds these gains, profits and income. I suppose, too, that the mere change from the hands of one trustee into those of another, of the fund which is the subject of the trust, would not make the whole fund, in the hands of the last trustee, gains, profits and income within the meaning of the revenue law. If this be so, then the inquiry must be, whether the one hundred thousand dollars of bonds, which in 1867 came to the hands of the plaintiff as trustee, was so much added to the wealth of the beneficiaries as a new acquisition; or whether it was not a mere change of an interest that had accrued before the year 1867 from the hands of one trustee into those of another."

The Court then concluded that, while the legal title to the bonds was never in the stockholders of the Railroad Company, yet they were the equitable owners of them and that, having been acquired in 1863 *prior to the enactment of the income tax law under which the assessment was made*, the stockholders had *an existing property right in them at the incidence of the tax law* and, consequently,

"the mere passage of this trust fund from the possession "of the old trustee, the corporation, into that of the new "trustee, the plaintiff, was not 'gains, profits or income' "accruing to the stockholders by that operation."

The recent decision of the United States Circuit Court of Appeals for the Eighth Circuit, in the case of *E. J. Lynch, Collector, v. Henry Turrish,* decided September 4th, 1916 (not yet officially reported), sustains precisely the principles which the respondents here assert. The facts in that case, as stated by the Court, were as follows:

> "The Payette Lumber and Manufacturing Company was a corporation organized in 1903 with a capital stock of $1,500,000 divided into 15,000 shares of the par value of $100.00 each of which Turrish owned in 1913 and 1914 799¾ shares of the par value of $79,975. The Payette Company began immediately after its organization in 1903 to invest its capital in timber lands in the State of Idaho and, prior to March 1, 1913, it had invested $1,375,000 thereof therein and the remainder thereof in other assets the ownership of which was incidental to the owning, holding and preservation of the timber lands. *During this time it did no business except such as was incidental to the ownership and care of these lands* and it made no dividends or payments of any kind to its stockholders. On March 1, 1913, the Payette Company still owned all the property and assets it had invested its capital in, and the value of these assets was not less than $3,000,000. The increase in the value of its property was due entirely to the gradual increase in the value of its timber lands between 1903 and March 1, 1913, and the value of the stock of Mr. Turrish was then twice its par value, or $159,950. In March, 1913, Mr. Turrish and all the other stockholders of the Payette Company gave an option in writing to purchase their stock for twice its par value. The holders of this option formed another corporation to which they transferred their option and that company preferred to purchase the property of the Payette Company to purchasing its capital stock. Thereupon, in December, 1913, that company offered to sell all its property to the Boise-Payette Company, the new corporation which held the option to purchase its stock, for $3,000,000 in cash on condition that the new company would assume its debts and liabilities. The offer was accepted and in March, 1914, the transaction was consummated. The Payette Company then had no assets but the $3,000,000 in cash and no liabilities not assumed by the Boise-Payette Company. It then distributed the $3,000,000 among its stockholders who surrendered their

stock and the corporation had since been dormant. In the distribution of the proceeds of the property of the company Mr. Turrish received $159,950, which was twice the par value of his stock. The Commissioner of Internal Revenue deemed one-half of this sum, or the par value, and the actual value in 1903, of the stock of Turrish, capital returned to him, and the other half, or the increase of the actual value of his stock between 1903 and March 1, 1913, by reason of the gradual advance during that time in the value of the timber lands of the Payette Company, income derived by him in 1914 from a dividend received from a domestic corporation subject to the income tax law. On this ground he assessed against Turrish an additional income tax of $127.12 on account of the second half of the $159,950. Turrish paid this tax under protest and brought this action for the return of the amount he paid. The court below was of the opinion that no part of this $159,950 was income taxable under the Act of October 3, 1913, and it accordingly overruled the demurrer and rendered judgment for the plaintiff."

After stating the facts as above, the Court observed that it seemed reasonable to say that the increase in the value of the Turrish stock, which had accrued prior to March 1st, 1913, on account of the gradual advance in the valuation of the corporate property prior to that date, could not be considered income, gains or profits of the stockholders taxable under the law.

> "(1) Because no income, gains or profits accrued to the stockholder during the year 1914, or after March 1, 1913; his property remained of the same value and gained nothing during that time; and (2) because the sale of the property of the corporation in 1914 and the distribution of its proceeds to the stockholders was a mere change of the form, without increase of the value, of the property he owned before the Income Tax Law took effect."

The Court then recited that the counsel for the United States contended that everything above the par value of the stock was income, (1) because the stockholder had no interest in the increased value of the corporate property until it was distribut-

ed to him by way of dividend; (2) because this distribution was made in 1914 for the first time and, therefore, became income to the stockholders, and (3) because the excess above par value was derived from a dividend received by him in 1914. These contentions were based upon the general rule that a stockholder has no legal right or title to the income, gains or profits of his corporation until a dividend has been declared.

The Court answered these contentions as follows:

> "But the tax authorized by the Act under consideration is an annual tax on the income, gains or profits arising or accruing after March 1, 1913, in the calendar year preceding the levy, and neither the rule itself nor any rational application of it is determinative of the question in what year this alleged income accrued or arose, or of the question whether the proceeds of the dividend were income or capital. If it were, then the entire $159,950 would, by the same mark, have become his income, gains and profits when the distribution was made in 1914, for it was all distributed to him by the same dividend, and until that dividend was declared he had no better legal title or right to any of the property of the corporation, or to the proceeds of any of it, than he had to the increased value of its timber land."

The Court then declares that although it is true that a corporation holds the legal title of, and the right to manage and control, its property, nevertheless the stockholders are the equitable and beneficial owners of all of its property, and the corporation is the mere holder and manager of it for them; the benefit of every increase in its value is the benefit of the stockholders, and the injury of every decrease of value is their injury. Continuing, it said:

> "Whether the value of the property of a corporation is increased by a gradual advance through a series of years of the value of the same real or personal property held throughout, or by undivided income, gains or profits, the actual value of its stock is immediately and proportionately increased and the holders of that stock may at any time convey their respective beneficial interests in that enhanced value, in those undivided profits, and in all the

other property of the corporation by sale, gift or devise. *The Collector v. Hubbard*, 12 Wall., 1. The position that a stockholder in a corporation has no interest in the enhanced value of its property or in its undivided income, gains, profits or surplus until a dividend thereof is declared, is untenable and may not prevail. * * * All the value of the property of a corporation and all the value of the stock of the plaintiff, whether it was due to capital assets, or income, or gains, or profits, or all of these combined, had arisen and accrued and had become their property before March 1, 1913. * * * The provisions of this law that the normal tax shall be levied annually upon the net income arising or accruing in the preceding calendar year * * * ending December 31st, except that for the year ending December 31st, 1913, it shall be computed upon the net income accruing from March 31st to December 31st, leave no doubt that *the Congress intended to and did exclude* from the burdens of the taxes it imposed by the Income Tax Act of October 3, 1913, *all income, gains and profits of every kind which had arisen or accrued prior to March 1, 1913.* It clearly intended to leave, and surely did leave, all the income, gains and profits which had accrued or arisen prior to that date, whether they were in the form of divided or undivided surplus, income, gains or profits, as free from every income tax it imposed, and as absolutely the property of their respective legal and equitable owners, as was any of their original capital or property. Now, the subsequent change by sale, distribution or otherwise of the form of the property held on March 1, 1913, without thereby enhancing its value or causing any gain, profit or income to its holders, as from real to personal property, or from stock to cash, does not subject it to the income tax, because it produces no gain, profit or income; it leaves the value of the property the same after as before the change. And as the sale of the property of the Payette Company in 1914, and the distribution of its proceeds to its stockholders by the dividend did not enhance the value of the property of the corporation or of the stockholders, or produce any gain, profit or income for them, but left the value of their property the same that it was before those transactions and the same as it was when the Income Tax Law took effect, the declaration and payment in 1914 of the dividend by which the proceeds of the sale of the property of the corporation were distributed to its stockholders did not transform the increased value of the plaintiff's stock which had accrued and arisen prior to March 1, 1913, into

> income, gains or profits accruing or arising subsequent to that date, and did not subject it to any income tax."

The principles thus so clearly expressed, apply to and control the cases at bar. The maximum value of the properties of the respondent companies was attained with the execution of the last mining contract on January 2, 1907, by the Sargent Land Company. From that time until January 1, 1909, that value was constantly diminishing as payments under the contracts were made, and the ultimate amounts receivable thereunder were thereby diminished. Whatever was received by the respondent companies after the first of January, 1909, was merely a conversion into money of the pre-existing values of the corporate assets, impossible, under the terms of the contracts, of increase or gain; and the distribution of such moneys to their stockholders constituted, as to them, a mere return of their invested capital as it stood at the effective date of the excise law.

The reasoning of the following additional sentences from the opinion of the Circuit Court of Appeals in the *Turrish case* is convincing here:

> "It is so inequitable, so unjust, so discriminatory to treat such an enhanced value accruing through many years before the enactment of an income tax law as the income, gains or profits of the year in which it happens subsequently to be distributed, that the following rule which is supported by the more forcible reasons and by the great preponderance of authority has become the established law in the Federal Courts. The enhanced value of property which accrues from the gradual increase in its value during a series of years prior to the effective date of an income tax law, although divided or distributed by dividend or otherwise subsequent to that date, does not become income, gains or profits taxable under such act. Such enhanced value, like the property of which it is an outgrowth and in which it inheres, becomes the absolute property of its legal and equitable owners before the effective date of the law and, as against such a law, thereafter remains their capital assets. *Gray v. Darlington,* 15 Wall., 63, 65, 66, 67; *Sargent Land Co. v. Von Baumbach,* 207 Fed., 423,

432; *Von Baumbach v. Sargent Land Co.*, 219 Fed., 31, 36, 37, 134 C. C. A. 649, 654, 655; *Gauley Mountain Coal Co. v. Hays*, 230 Fed., 110; *Industrial Trust Co. v. Walsh*, 222 Fed., 437; *Mitchell Bros. Co. v. Doyle*, 225 Fed., 437, 439, 440; *Doyle v. Mitchell Bros. Co.* (6th Circuit), filed June 3, 1916; *Hudson's Bay Co. v. Stevens*, 25 L. T. R., 709, 5 Tax Cases, 424, 436, 438, 439; *Tebrau (Johore) Rubber Syndicate, Ltd., v. Farmer*, 47 Scot. L. R., 816, 5 Tax Cases, 658.

"Because no income, gains or profits accrued to the plaintiff during the year 1914, or after March 1, 1913, but during that time his property remained of the same value, and because the sale of the property of the Payette Company in 1914 and the distribution of its proceeds by a dividend to its stockholders was but a change of the form, without any increase of the value, of the property he owned before the Income Tax Law of 1913 took effect, there was no error in the judgment below and it is affirmed."

At the same time with the decision in the *Turrish case*, a decision was handed down by the Circuit Court of Appeals for the Eighth Circuit in the case of

Lynch, Collector, v. Hornby,

the facts in which differed somewhat from those in the case of Turrish, the distinction emphasizing the soundness and force of the principles declared in the former opinion. Inasmuch as neither of these opinions has been as yet officially reported, the following somewhat extended excerpt from the opinion in the *Hornby case*, is here inserted:

"Hornby was the owner of 434 shares of the capital stock of the Cloquet Lumber Company from 1906 until 1915. That company was a corporation of Iowa which for more than a quarter of a century has been engaged in purchasing timber lands, manufacturing the timber into lumber and selling it. It had a capital stock of $1,000,000 divided into 10,000 shares of the par value of $100 each. On March 1, 1913, by the increase of the value of its timber lands and by its business operations it had become possessed of property which was worth four times the par value of its stock or $4,000,000, its timber had become worth ten dollars per thousand feet, and the stock of Mr. Hornby, the par value of which was $43,400, had become worth at least $150,000. In the year 1914 the Cloquet Company was en-

gaged in converting its standing timber into money and distributing it among its stockholders by cutting the timber, manufacturing it into lumber and selling the lumber. In that year it distributed to its stockholders in dividends $650,000. Of these distributions $240,000, or 24% of the par value of its capital stock, was derived from the net earnings and profits of the company during the current period, and $410,000 was derived from moneys realized during the year 1914 by the Cloquet Company from the conversion into money by it of property which it owned, or in which it had an interest, on March 1, 1913. Hornby received during the year 1914 $10,416 from the distribution of these net earnings and profits of the company and $17,794 out of the distribution of these moneys realized from the conversion into money of the property which the Cloquet Company owned or had an interest in on March 1, 1913. The property out of which the $410,000 was realized was of the value of $410,000 on March 1, 1913, and the conversion of it into money and the distribution thereof diminished the value of the Company's property as it was on March 1, 1913, by that amount, and diminished the value of Mr. Hornby's stock as it was on March 1, 1913, and increased his cash, $17,794. In his income tax return for the year 1914, Mr. Hornby included the $10,416 he received out of the income and profits of the Cloquet Company during that year and he paid an income tax without protest upon a computation which included this amount, but he did not include the $17,794 which he received out of the moneys realized in 1914 by the Cloquet Company from the conversion into money of property which it owned or had an interest in on March 1, 1913. The Commissioner of Internal Revenue deemed this $17,794 taxable income to Mr. Hornby and on account of it levied an additional tax of $171 which Mr. Hornby paid under protest and brought this action to recover.

"Counsel for the United States complains that the complaint does not state facts sufficient to constitute a cause of action because it does not state the original cost of the timber or other property which the Cloquet Company acquired before and owned on March 1, 1913. But that omission is immaterial because it does state the value of the property which that Company owned and was interested in on March 1, 1913, which was converted into money and distributed to its stockholders in 1914, and that this conversion and distribution diminished the value of its property as it was on March 1, 1913, and as it was just before the conversion and distribution, by $410,000, and

diminished the value of Mr. Hornby's stock as it was on March 1, 1913, and as it was just before the sale and distribution, by $17,794. As none of the property which the Cloquet Company or Hornby held on March 1, 1913, whether it was original capital or previously earned surplus, income, gains or profits, was intended to be made or was made taxable as income by the Income Tax Law of 1913, the complaint stated facts sufficient to show that this $17,794 was not so taxable."

For the reasons stated in the opinion in the *Turrish case,* and because no income or gain accrued after March 1, 1913, by the conversion into money of the timber owned by the company to the extent of $410,000, and because the effect of that conversion and distribution was simply to change the form of a part of the property which Mr. Hornby owned on March 1, 1913, from capital stock into $17,794 of money, the judgment was affirmed.

Inasmuch as the Cloquet Lumber Company, after March 1, 1913, actively engaged in the business of manufacturing its standing timber into lumber and disposing of the same, the line was necessarily drawn between the distribution of its converted capital at its value on March 1, 1913, and the distribution of earnings during the tax period. No question could be raised respecting the liability of the stockholder to pay an income tax upon the earnings so distributed to him, and, with equal certainty, no liability to taxation attached to him in respect of that portion of the distribution which represented the value of his invested capital on March 1, 1913.

In *Gray v. Darlington,* 82 U. S., 63, the short facts, as stated by the Court, were as follows:

The plaintiff was the owner of certain treasury notes which he exchanged in 1865 for United States bonds. He sold the bonds in 1869 at an advance over the cost of the treasury notes of $20,000.00, and an income tax of five per centum was assessed against him upon this amount under the Act of March

2nd, 1867, upon the assertion that the $20,000.00 were gains, profits and income of the plaintiff for the year 1869.

The Court held:

"The question presented is whether the advance in the value of the bonds, during this period of four years, over their cost, realized by their sale, was subject to taxation as gains, profits or income of the plaintiff *for the year in which the bonds were sold.* The answer which should be given to this question does not, in our judgment, admit of any doubt. The advance in the value of the property during a series of years can, in no just sense, be considered the gains, profits or income of any one particular year of the series, *although the entire amount of the advance be at one time turned into money by a sale of the property.* The statute looks, with some exceptions, for subjects of taxation only to annual gains, profits and income. Its general language is 'that there shall be levied, collected, and paid *annually* upon the gains, profits and income of every person,' derived from certain specified sources a tax of five per cent., and that this tax shall be 'assessed, collected, and paid upon the gains, profits, and income for the year ending the 31st of December, next preceding the time for levying, collecting, and paying said tax.' (14 Stat. at Large 477-8, Sec. 13.) This language has only one meaning and that is that the assessment, collection, and payment prescribed are to be made upon the annual products or income of one's property or labor, or such gains or profits as may be realized from a business transaction begun and completed during the preceding year. * * * (p. 65).

"The mere fact that property has advanced in value between the date of its acquisition and sale does not authorize the imposition of the tax on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits, or income specified by the statute. It constitutes and can be treated merely as increase of capital.

"The rule adopted by the officers of the revenue in the present case would justify them in treating as gains of one year the increase in the value of property extending through any number of years, through even the entire century. The actual advance in value of property over its cost may, in fact, reach its height years before its sale; the value of the property may, in truth, be less at the time of the sale than at any previous period in ten years, yet, if the amount received exceeds the actual cost of the property, the excess is to be treated, according to their views, as gains of the owner for the year in which the sale takes

place. We are satisfied that no such result was intended by the statute" (pp. 66-67).

The whole theory of the Act of 1909 is that it "does not impose direct taxation upon property solely because of its ownership" (*Flint v. Stone-Tracy Co.*, 220 U. S., 150), but "the tax is laid upon the privileges which exist in conducting business with the advantages which inhere in the corporate capacity of those taxed" (Id., 162). "And the measure of the tax is the income, with the deduction ($5,000) stated" (Id., 146).

In other words, those employing "the advantages which inhere in the peculiarities of corporate or joint stock organization" (Id., 146) pay an excise tax therefor *measured by the benefits* which they derive from the use of such advantages in each tax year.

Did the respondents derive any benefit by any corporate action, or by the exercise of "the particular privilege of doing business in a corporate capacity" (Id., 151), during any of the years 1909, 1910 and 1911? Were not all the moneys accruing to them secured by the execution of the mining contracts years before?

What were the benefits, if any, received by the respondents? The Commissioner of Internal Revenue contends that all of the moneys received under the contracts in the years in question were benefits in the form of gross income by which the tax of the respondents should be measured. His contention, therefore, must be that the moneys received during each of said years were the product of exercising the privilege of doing business in a corporate capacity during the same, and that they were not only gross income, but were gross income *derived from doing business in those years.* If, however, they were the result of corporate action in the years 1906 and 1907, and were received by the corporations without any further or other act upon their part during the three years here involved, how can they be charged as gross income for those three years? For

"if business is not done in the manner described in the statute, no tax is payable" (220 U. S., 152).

Regulations of Treasury Department Relating to Computation of Income.

As soon as might be after the enactment of the Excise Law, the Secretary of the Treasury issued a circular, under date of December 3, 1909, (Treasury Decision No. 1571), embodying regulations in respect of the corporation tax and setting out, in part, the Government's interpretation of the law. In that circular we find the following language:

> "Article 2—*Gross income.* The following definitions and rules are given for determining the gross income for the various classes of corporations:
>
> 1A. *Banks and other financial institutions.* * * *
>
> 1B. *Insurance companies.*—Same as 1A above.
>
> 2. *Transportation companies.*—same as 1A above.
>
> 3. *Manufacturing companies.*—Gross income received during the year from all sources will consist of the total amount, ascertained through an accounting, that shows the difference between the price received for goods as sold and the cost of such goods as manufactured. * * *
>
> 4. *Mercantile companies.*—Gross amount of income received during the year consists of the total amount ascertained through inventory, or its equivalent, which shows the difference between the price received for goods sold and the cost of goods purchased during the year, with an addition of a charge, to the account, of the sum of the inventory at the beginning of the year, and a credit to the account of the sum of the inventory at the end of the year.
>
> 5. *Miscellaneous.*—Gross income consists of the gross revenue derived from the operation and management of the business and property of the corporation making the return, together with all amounts of income * * * derived from all other sources, as shown by the entries on the books from January 1 to December 31 of the year for which return is made.
>
> It will be noted from these definitions that gross income is practically the same as gross profits, the only difference being that gross income is more inclusive, embracing, as it does, not only gross profits of the corporation but also all amounts of income from other sources.

6. *Sale of capital assets.*—In ascertaining income derived from the sale of capital assets, if the assets were acquired subsequent to January 1, 1909, the difference between the selling price and the buying price shall constitute an item of gross income to be added to or subtracted from gross income, according to whether the selling price was greater or less than the buying price. *If the capital assets were acquired prior to January 1, 1909, the amount of increment or depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909, and which proportion shall be deducted from or added to the gross income for the year in which the sale was made.*"

By Treasury Decision No. 1588, January 24th, 1910, an additional exposition of the Act was given as follows:

"The provisions of the law require—

1. That the return shall show *the gross income (profit) received during the year*, which is reported in item 3 on form 637. * * *

To make a correct return it is necessary for the accountant to know—

1. The exact resources and liabilities of a corporation *both on January 1 and December 31 of the year covered by the same.*

2. A full statement of the business transacted during the year.

For example: * * * *A business transaction that results in exchanging these assets, or any part of them, for anything of equal value does not produce income.* * * *

Any increase or decrease in value accruing at a time prior to January 1st of the calendar year for which return is made, cannot be taken as a part of the gross income from that year, but, as noted above, such increase or decrease in value should be included in the account of the prior calendar year. * * * And it is not at all material in making a return for the year 1909 if * * * the goods were purchased prior to that time. *On January 1st, 1909, the goods referred to constitute capital assets* at the invoiced value, and *only the profits* on the same, if sold during the year, *are taken as gross income*, or if not all sold during the year, gross income is found by an addition to the credit side of the account of the sum of the inventory at the close of the year."

Again, in Treasury Decision No. 1606, March 29th, 1910, we find:

"72. Depreciation in value of mines *by the removal of ore, if not otherwise ascertainable,* may be pro-rated as in the case of sales of capital assets.

"75. Corporations leasing mines [lessees] and paying royalties on ore mined are not entitled to deduction for depreciation. *But corporations owning mines are entitled to allowance for depreciation based on fair estimate,* etc.

"76. Removal of timber from timber lands, while depleting the lands to the extent of such removal, *is regarded as a change in the form of assets* and not a depreciation within the meaning of the Act."

In Treasury Decision, No. 1675, February 14, 1911, rules were laid down as follows:

"55. *Lands bought previous to January 1st, 1909, and* sold during the year 1910, *should have the profits arising from such sale pro-rated in accordance with the number of years the land was held by the corporation and the number of years the law was in effect,* if no accounting of increased value of land was made in returns for previous years.

"75. A mere removal of timber by cutting from timber lands, unless the timber is otherwise disposed of through sales or plant operations, is considered simply *a change in form of assets.* If such timber is disposed of through sales or otherwise, it is to be accounted for in accordance with regulations governing *disposition of capital and other assets.*

"83. *An estimate should be made January 1, 1909,* of the fair market value at that date of the mineral, etc., in deposit. This estimate should be formed on the basis of the disposal value of the minerals in total and exclusive of value of improvements and development work. This valuation should also be reduced to a unit value—per ton, barrel, etc.

"*Note.*— * * * The value to be determined as stated must be on the basis of the saleable value of the entire deposit of the aggregate units of minerals considered *en bloc, if disposed of in that form.* Nor must such valuation comprehend any speculative value which might attach to a sale of the minerals *en bloc,* i. e., a value which might be obtained on the ground that the future would develop a much greater reserve

of mineral deposits than were believed to exist at the time the estimate of January 1, 1909, was formed. Any value of this latter character would attach obviously to such additional reserves when developed in future.

"84. *The unit value as of January 1, 1909,* ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding, and should be used in determining *the unearned increment at January 1, 1909, which may be excluded entirely from the item of gross income,* as before explained, in the following manner, viz:

Value at January 1, 1909, determined in manner outlined, of minerals, etc., which may be removed and disposed of in any year subsequent thereto, $.....

Less the following:

(a) Proportion of depreciation charge applying to exhaustion of minerals disposed of, ascertained as first explained herein on basis of original cost, $.....

(b) Royalty paid, if any, on minerals disposed of, $.....

Balance, being unearned increment at January 1, 1909, to be excluded from gross income item $.....

In Treasury Decision No. 1706, June 9, 1911, with reference to the disposition of *securities,* it is provided that, where no entry of appreciation is made on the books, the gain accruing upon a sale of the securities shall be pro-rated according to the number of years the securities were held prior to sale, and *the amount so apportioned for each year after January 1, 1909, "the beginning of the period when the corporation excise tax law became effective" shall be accounted for as income.*

Likewise, in Treasury Decision No. 1742, December 15, 1911, we find:

"62. In the case of lands bought prior to January 1, 1909, and sold during any subsequent year, the profits arising from such sale, if no accounting of increased value of land was made in return for previous years, should be pro-

rated in accordance with the number of years the land was held by the corporation and *the number of years the law was in effect.*"

Treasury Decision, No. 1742 constituted a revision of former regulations, paragraphs 97, 98, 101, 103 and 105 of which are of interest at this point, and read as follows:

"97. In the ascertainment of net income deduction will be allowed for depreciation arising from exhaustion of deposits of ore, mineral, etc., and for depreciation and obsolescence of improvements, in accordance with general regulations respecting depreciation allowances, on the basis of *the original capital investment cost* of the properties concerned to the company reporting.

"98. A further deduction will also be allowed, through not including the same at all in the item of gross income, for *the unearned increment* represented in such properties as at January 1, 1909.

"101. * * * The question as to whether it subsequently develops [that] the property possessed a greater quantity of mineral, etc., reserve than was, in the aggregate, estimated as of January 1, 1909, is immaterial. Any excess which may be developed will be considered as possessing the same value at January, 1909, as that which then may have been known to be in the property.

"103. As the amount to be deducted for depreciation is to be formed on the basis of the estimated reserve of minerals, etc., it follows that if it develops [that] such estimate is understated, the cost investment in the capital assets may be wholly extinguished before all mineral reserves are removed. When this is reached, *further deductions for exhaustion of minerals should be discontinued,* but in such event it will be noted, the allowance for unearned increment, which is to be excluded entirely from gross income, will be correspondingly increased.

"105. In respect to properties of the character in question, which may be acquired by a corporation *after* January 1, 1909, a deduction will be allowed only as to depreciation arising from exhaustion, *based on original cost; no exclusion from gross income can be made for unearned increment, as profit arising from any sale of such capital assets applies wholly to the period subsequent to January 1,1909.*"

ing and mercantile companies were all permittted to deduct from their gross receipts the value of their assets used in manufactures or sold in the course of trade; and, as to corporations other than manufacturing and mercantile companies, the rule was expressly laid down that "gross income consists of the "gross revenue *derived from* the operation and management of "the business and property of the corporation making the re- "turn."

The words "derived from" in that definition, as in the definition given by *Mr. Justice Pitney* in *Stratton's Independence, Ltd., v. Howbert* ("Income may be defined as gain derived from capital or labor or from both combined"), mean, and can only mean, *produced by* or *gained out of*, the property, or capital, leaving that intact.

It will be observed, from an examination of the Treasury Decisions which have been quoted, that the Commissioner of Internal Revenue established, as an inelastic regulation, the rule of ratable apportionment, to the years intervening between their acquisition and sale, of the increased values of corporate assets; and that he exempted from taxation that proportion of such increased values as attached to the years preceding January 1, 1909.

We have seen that, under the decisions of the Federal Courts, only the *actual* increase after the date of the incidence of a tax of this character can be taken into account, and that all increment preceding that date represents at that time (as far as the tax law is concerned) invested capital.

Does not the rule of apportionment promulgated by the Commissioner necessarily concede this? It pro-rates the increased value over the years elapsing between purchase and sale, and exempts the proportion allotted to the period prior to January 1, 1909. This can only be for the reason that any increment accruing before that date must be recognized to be capi-

tal investment and not income; hence, only the proportion *assumed* to have accrued after January 1, 1909, is directed to be classed as income to afford a measure for taxation.

The error of the Commissioner lies in making an arbitrary determination by proportion instead of ascertaining *the actual fact.*

Bailey v. R. R. Co., 106 U. S., 109, *supra.*
Gray v. Darlington, 82 U. S., 63.

If, in fact, the entire increase in value in a given case accrued before January 1, 1909, then, of course, it was all part of the taxpayer's invested capital at that date, for he could turn it into money at that value before the law became effective, and it represented his financial worth and property so far as that particular item was concerned.

Doyle v. Mitchell Bros. Co., C. C. A., 6th Circuit, *supra.*
Lynch v. Turrish, C. C. A., 8th Circuit, *supra.*

Applying the principle underlying the regulations referred to to the cases now before the Court, it is seen that, from the time the mining contracts covering the respondents' lands were executed, the value of the ore sold under those contracts being fixed and inflexible, the value of the respondents' rights in the contracts was likewise fixed, and that there was no advance or gain or profit possible thereafter.

It is accordingly submitted that, during the years 1909, 1910 and 1911 the respondents received no gross income and were not liable to pay an excise tax for those years.

POINT IV.

The Respondents Derived no Net Income for the Years 1909, 1910 and 1911; and, herein, the question of "Depreciation."

On the 31st of December, 1908, the respondents, respectively, were the owners of the legal title to certain lands in Minnesota, subject to outstanding contracts, by virtue of which *other parties* owned the exclusive right of occupancy and control of the premises, paid all taxes and assessments levied upon or against the same, and possessed the similar exclusive right of mining, removing, owning and selling all iron ore that might be in the lands.

The excise law became effective as of January 1, 1909. Since that date the respondents have engaged in no business, have made no investments of any kind, and, as rapidly as their property has been converted into money, have distributed it to their stockholders in pursuance of the chief purpose of their organization.

The mining contracts referred to were, in effect, conditional contracts of sale effectual to prevent any control, use or subsequent disposal of the ores by the respondents as long as the grantees in the contracts observed the conditions therein expressed. The fact that the contracts may be terminated at some time in the future through a default of the grantees, or by their election to surrender the same, is an entirely immaterial consideration. There is no presumption of such a situation arising, and, should the contracts be terminated, an entirely new situation would be created the effect of which could only be determined thereafter. In the case of *McCoach v. Minehill Co.*, 228 U. S., 291, 304, this was expressly recognized when, speaking of the lease made by the Minehill Company of its railway properties, this Court said that the effect was,

"—to constitute the Reading Company the public agent for the operation of the road and to prevent the Minehill Company from carrying on business in respect of the maintenance and operation of the railroad *so long as the lease shall continue.*"

The respondents have no power to terminate the contracts so long as their terms are observed by the grantees therein, and, during their continuance in force, can receive from the properties only the sums covenanted to be paid thereunder. Should it happen that the properties again come into their possession and control, the liability of the respondents to pay a tax will be a question then to be determined, depending upon the manner in which they may see fit to handle or dispose of the properties.

State Line Co. v. Davis, 228 Fed., 246.

These contracts fixed a definite and unchangeable price for the ores beyond which the respondents were entitled to, and could, look for nothing more. The value of their capital assets therein on January 1st, 1909, as represented by their interest in the lands, was precisely what it was on the 31st day of December, 1911 (the end of the period with which these suits are concerned), except for the diminution therein by payments made under the contracts. By those payments the obligations to pay, represented by the contracts, were correspondingly reduced. On January 1st, 1909, the respondents had all of the property which they ever will have, and their only receipts have been the proceeds of its diminution and exhaustion. It is accordingly evident that they have had no gross income whatsoever in the sense in which that term must be interpreted. Their iron contracts (which are the source of their receipts) are a part of their invested capital. If their cash receipts had been retained in the treasuries of the companies, each company, on the 31st day of December, 1911, would have owned exactly the same amount of property, or capital, that it owned

on the first day of January, 1909, less the incidental expenses incurred in the interim.

The fact that the companies distributed these capital receipts to their stockholders as soon as they came in, is immaterial from any point of view. The depletion of the invested capital arises from the reduction in value of the assets represented by the contract obligations, through the periodic payments made thereunder, and not from the distribution of those payments, when received, to stockholders.

It has resulted in these cases that the values of the capital assets of the respective land companies on the 31st day of December, 1911, were smaller than they were on the first day of January, 1909, by the amounts shown on page 17 of this brief, the same being the amounts received and distributed by each of the companies for the three years. It thus conclusively appears that the stockholders of the Sutton Land Company, by way of illustration, owned, at that date, $75,310 less than they owned on January 1, 1909, because the value of their contracts had been reduced by payments thereunder in that aggregate sum. And so of the other companies.

The accuracy of these statements is self evident.

Net Income: How Computed.

The excise law imposes upon corporations organized for profit a special excise tax with respect to the carrying on or doing of business by such corporation, "equivalent to one per "centum upon the entire *net income,* over and above $5,000.00, "received by it from all sources during such year, exclusive of "amounts received by it as dividends of stock of other corpora-"tions."

It is further provided that such *net income* shall be ascertained by deducting from "the *gross* amount of the income" of the corporation all ordinary, necessary expenses actually paid

within the year *out of income;* all losses sustained within the year and not compensated by insurance or otherwise; "a reasonable allowance for depreciation of property, if any"; interest paid within the year, to a limited amount; taxes paid within the year, and all amounts received as dividends upon stock of other tax-paying corporations.

The law necessarily assumes a *gross income*, and, unless there be a gross income, no net income, susceptible of being used as a measure of an excise tax, can exist. It has been demonstrated, we think, that these respondents had no gross income.

We are confronted, however, by the insistence of the petitioner that the *gross receipts* of the respondent companies constituted *gross income*, and, except for the insignificant deductions for expenses and taxes, and the specific deduction of $5,000.00 per year, became the measure of the tax to be imposed by the Commissioner. We cannot assent to, and have already discussed, this phase of the case.

If, however, it be assumed that the claim of the Treasury officials is correct, the question arises

Are the Respondents not entitled to an Allowance for Depreciated Value of their Invested Capital?

Respecting this inquiry (which was not considered by the District Court), the Circuit Court of Appeals said, at page 154 of the transcript:

> "If there were error in the conclusion that the receipts of the companies from their collections of the amounts of their claims against the lessees, which came due in 1909, 1910 and 1911 for the purchase price of, or the royalties on, the ore, were not included in their gross income, if they were a part of that gross income, then the companies would have been entitled to 'a reasonable allowance for depreciation of property' by the reduction of the values of their claims by these payments. *Strattons' Independence, Ltd., v. Howbert,* 231 U. S., 399, 418. And as the payments on

these claims unavoidably reduced and depreciated their value, as has been shown, by the amounts paid, there would have been no net income from them on account of which an excise tax could have been lawfully exacted. *United States v. Nipissing Mines Company,* 202 Fed., 803, 805; *Stevens v. Hudson's Bay Company,* 101 L. T. Rep., 96, 97, 98."

See, to the same effect,
Forty Fort Coal Co. v. Kirkendall, 233 Fed., 704, quoted on page 140 *supra.*

If the mineral properties and contracts were capital assets of the corporations, and if their values were lessened by the removal of, and payment for, ore by the lessees, then the provision for a deduction of a reasonable allowance for depreciation immediately becomes operative, as a matter of right conferred upon the respondents by the Act of August 5th, 1909.

How is Depreciation Arrived At?

We refer again to paragraph 6 of the Regulations of the Treasury Department, issued December 3rd, 1909:

"6. *Sale of Capital Assets.*—In ascertaining income derived from the sale of capital assets, * * * if the capital assets were acquired prior to January 1, 1909, the amount of increment or depreciation representing the difference between the selling and buying price, is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909 * * *."

Also paragraph 97 of the Regulations issued December 15th, 1911:

"In the ascertainment of net income, deduction will be allowed for depreciation arising from exhaustion of deposits of ore, minerals, etc., and for depreciation and obsolescence of improvements, in accordance with general regulations respecting depreciation allowances, on the basis of the original capital investment cost of the properties concerned to the company reporting."

The Commissioner has never revoked or repudiated these regulations, either generally or with reference to the present

cases.

The position of the Commissioner, in the cases at bar, has been, up to this time, only that the respondents were entitled to no allowance for depleted values of their capital assets *because no depreciation account was kept by them and no reduction of capital values was entered upon their books.*

The examination of the witness *Schouler,* the accountant of the Treasury Department who made the investigation of the books and records of the respondents, shows this very clearly. We quote from the record, at pages 108, 110 and 111:

> "*Direct Examination.* Q. Did you find upon the books of either of the plaintiff companies, any claim for depreciation?
>
> "A. Nothing on the books at all.
>
> "Q. There was no depreciation charged on the books?
>
> "A. No, sir.
>
> "*Cross Examination.* Q. But isn't it a fact, speaking broadly, that the difference between the account which you claim is correct, the account made up by you, and the account filed by the companies for the same year, is in the amount claimed by the companies to be allowed for depreciation, consisting of the amounts received by them on account of ore sold, on account of lands sold, and, in some cases, on account of timber sold?
>
> "A. In some cases that is possible.
>
> "Q. But speaking generally, the difference between your account and theirs was that they claimed for depreciation of the property on account of sales of ores, sales of lands and sales of timber?
>
> "A. The difference between the original and the other return is the claim for depreciation. * * *
>
> "Q. Is it or is it not a fact that you, in making up what you call the correct return for these companies, omitted all the items of depreciation for the reason that, under their system of bookkeeping, they did not maintain a so-called depreciation account?
>
> "A. It is a fundamental principle that they [the Treasury Department] will not accept any claim for depreciation unless it is evidenced by some reduced value of assets.
>
> "Q. That was the sole ground of objection to the depreciation items found in the returns made by the companies; it was the fact that their books did not have any depreciation account?

"A. That is the practical question. It must be on the books first; afterwards it is decided on its merits.

"Q. If there had been a depreciation account kept in the books of these companies would you have looked into it?

"A. I would have gone into the matter as fairly as possible, threshed it out and put it up to the Department.

"Q. Would you have made, in what you call your correct return, an allowance for depreciation?

"A. Yes, sir, I would have made a return based upon my examination. * * *

"Q. The fact is, is it not, that you struck out any allowance, in what you called the correct return, on account of depreciation because there was nothing shown on the books, and it was left to the Commissioner? Please answer yes, or no.

"A. I can't answer your question yes, or no, because of the peculiar conditions. * * * My figures are simply based upon the fact that there is no depreciation on them [the books]. * * *

"Q. You know the Commissioner claimed that you had gone into this on its merits; but as far as that report was concerned, you intended that as a report of what the books showed?

"A. My return threw out the claim because it was not evidenced."

The "fundamental principle" of the Department, referred to and applied in these cases, clearly proceeds upon the doctrine of estoppel.

An estoppel is such an act, admission or declaration as precludes its author from saying the truth. It precludes the truth in order to prevent fraud and falsehood and to protect innocent parties relying upon the acts, admissions or declarations of another; it imposes silence upon a party only when, in conscience and honesty, he should not be allowed to speak.

Van Rensselaer v. Kearney, 11 How., 297.

The rule, of course, is universal that estoppels, to be good, must be mutual; that is, an estoppel can be invoked only by one who, but for its invocation, would be damnified. No more than in the case of one of its citizens, will the Government be

allowed to exact payment of an unjust claim by the application of an alleged estoppel.

The "fundamental principle" of the Department, applied in these cases, results in this very thing.

The negative act of the respondents of omitting to keep depreciation accounts in their books is, by the Commissioner, made conclusive against the fact of any depletion or depreciation. The effect of the enforcement of such a rule is the exact opposite of what an estoppel produces; it imposes silence when, in conscience and honesty, a party should be allowed to speak.

The Commissioner's Power to Prescribe Regulations Does Not Authorize Him Thereby to Enlarge the Statute.

Morrill v. Jones, 106 U. S., 466;
United States v. Symonds, 120 U. S., 46;
United States v. United Verde Copper Co., 196 U. S., 207;
Williamson v. United States, 207 U. S., 425.

In the case first cited, section 2505 of the Revised Statutes provided that animals imported for breeding purposes should be admitted free of duty under such regulations as the Secretary of the Treasury should prescribe. The defendant imported certain animals for breeding purposes and was required to pay duty, because the Collector was not satisfied that they were of superior stock. This court said:

> "The Secretary of the Treasury cannot, by his regulations, alter or amend the revenue. All he can do is to regulate the mode of proceeding to carry into effect what Congress has enacted. In the present case, we are entirely satisfied that the regulation acted upon by the Collector was in excess of the power of the Secretary. The statute clearly includes animals of all classes. The regulation seeks to confine its operation to animals of superior stock. This is manifestsly an attempt to put into the body of the statute a limitation which Congress did not think it necessary to prescribe."

The aptness of this declaration to the situation in the present cases is striking. Although the Congress has granted to every corporation subject to the excise tax a deduction from gross income on account of depreciation, the Commissioner has attempted to amend the law by adding a *proviso* that such depreciation must be shown upon the books of the company.

In the *Symonds case,* a regulation of the Secretary of the Navy resulted in reducing the salary to which an officer was entitled under the law, by prescribing that certain services rendered aboard ship should be regarded as shore service. This court said, in holding the Secretary's regulation invalid:

> "All the different kinds of service described therein are services performed at sea, in the meaning of §1556. But they are to be deemed such, not because the Secretary of the Navy has announced that the Department will so regard them, but because they are, in fact, services performed at sea, and not on shore. If the regulations of 1876 had not recognized services 'on board a practice ship at sea' as sea service, the argument in behalf of the Government would imply that they could not be regarded by the courts, or by the proper accounting officers, as sea services; in other words, that the Secretary of the Navy could fix, by order, and conclusively, what was and what was not sea service. But Congress certainly did not intend to confer authority upon the Secretary of the Navy to diminish an officer's compensation, as established by law, by declaring that to be shore service which was, in fact, sea service, or to increase his compensation by declaring that to be sea service which was, in fact, shore service. The authority of the Secretary to issue orders, regulations and instructions, with the approval of the President, in reference to matters connected with the naval establishment, is subject to the conditions, necessarily implied, that they must be consistent with the statutes which have been enacted by Congress in reference to the navy. He may, with the approval of the President, establish regulations in execution of, or supplemental to, but not in conflict with, the statutes defining his powers, *or conferring rights upon others.*"

The Act of 1909 gave to every corporation paying taxes under its provisions the deduction of a reasonable allowance for de-

preciation, not as a matter of grace, in the discretion of the Commissioner, but as a right expressly conferred whenever such depreciation might take place, *in fact*.

In the *United Verde Copper Company case*, an act of Congress permitted the cutting and removal of timber from public lands for building, agricultural, mining or other domestic purposes. The Secretary of the Interior promulgated a regulation that no timber could be used for smelting purposes. In an action brought to recover the value of the timber cut and removed from public lands by the defendant and used for smelting ores, this Court said (pages 214-15):

> "The government relies on the rules and regulations of the Secretary of the Interior, promulgated under, as it is contended, the authority of the statute since *United States v. Richmond Mining Company* (40 Fed., 415) was decided. No. 7 of those regulations provides that 'no timber is permitted to be used for smelting purposes, smelting being a separate and distinct industry from that of mining.' By this the Secretary of the Interior may have intended to supersede the ruling in *United States v. Richmond Mining Company*, but to which industry the roasting of ore shall be assigned the Secretary does not say, and the considerations which we have expressed apply as well to the regulation as to the statute. But there is a more absolutely fatal objection to the regulation. The Secretary of the Interior attempts by it to give an authoritative and final construction to the statute. This, we think, is beyond his power. * * * If Rule No. 7 is valid, the Secretary of the Interior has power to abridge or enlarge the statute at will. If he can define one term, he can define another. If he can abridge, he can enlarge. Such power is not regulation: it is legislation. The power of legislation was certainly not intended to be conferred upon the Secretary."

Williamson v. United States was a case involving a regulation of the Commissioner of the General Land Office requiring an entryman under the Timber & Stone Act of June 3rd, 1878, to make oath, *on final hearing*, of his *bona fides* in making his entry and of the absence of contract or agreement in respect of the title. The law required an applicant for *entry* to swear

to his good faith and to the absence of any speculative purpose, but the requirement was not re-imposed in respect of final proof. The Commissioner, however, exacted such affidavit with final proof. This Court said (pages 461-2):

> "It remains only to consider whether it was within the power of the Commissioner of the General Land Office to enact rules and regulations by which an entryman would be compelled to do that at the final hearing which the act of Congress must be considered as having expressly excluded, in order thereby to deprive the entryman of the right which the act by necessary implication conferred upon him. To state the question is to answer it. * * * True it is that in the concluding portion of §3 of the timber and stone act it is provided that 'effect shall be given to the foregoing provisions of this act by regulations to be prescribed by the Commissioner of the General Land Office,' but this power must, in the nature of things, be construed as authorizing the Commissioner of the General Land Office to adopt rules and regulations for the enforcement of the statute, and cannot be held to have authorized him, by such an exercise of power, to virtually adopt rules and regulations destructive of rights which Congress had conferred."

The effect of the regulation of the Commissioner of Internal Revenue that no depreciation will be recognized unless it be evidenced by book entries, is to deprive tax-paying corporations, which have not seen fit to adopt a system of bookkeeping that embraces such entries, of the deduction expressly given to them by the Act of August 5th, 1909.

Accordingly, it is submitted:

The Requirement of Depreciation Entries in Corporate Books is Arbitrary and Futile.

Judge Willard, in the District Court, said: "Nor do I attach any importance to the fact that, upon the books, the companies carried no 'depreciation' account." (Page 122).

In *Doyle v. Mitchell Bros. Company*, already referred to, decided by the Circuit Court of Appeals, Sixth Circuit, June 30th, 1916, but not yet reported, the Court said:

"There is nothing magical in bookkeeping; it does not create facts; it only records them. A citizen cannot be rightly taxable in one way if he keeps books and in another way if he keeps none; nor in one way if his books are accurate and kept up to date, and in another way if they are imperfect and neglected. Book entries may be of value as an admission when a tax is to be assessed and when there is a dispute as to the fact, but they cannot work as an estoppel as to an undisputed fact. The insistence of the Commissioner that this $20.00 an acre appreciation is income for the year in which the timber happens to be cut rests at last upon the theory that the taxpayer is estopped to claim that it was income for an earlier period because he had not so entered it on his books; and this theory we cannot accept. Its formal transfer into surplus or undivided profits account would have done nobody any good or any harm. Until this law was passed, it was a matter of indifference to the corporation and to the stockholders whether profits were entered up at one time or another, and any attempt after August, 1909, to make a book entry of these gains, *nunc pro tunc,* as of December, 1908, would only have invited adverse comment. On this subject there cannot be one rule for a corporation and another for an individual. If this property had continued to be owned by the partnership which preceded the corporation, there might have been no capital account representing the land and timber. The existence or not of such an account would have been incidental to the bookkeeping system adopted. It is only the existence of the capital stock of a corporation which compels the maintenance of an account showing the corresponding assets. So, we find ourselves unable to give any controlling force to the fortuitous circumstances that, in this case, the capital account was carried under the name of 'Land and Timber,' and that the accretions had not been entered."

In *United States v. Nipissing Mines Company,* 202 Fed., 803, the same view was taken by Circuit Judge *Lacombe,* who said:

"The suggestion that there can be no allowance for depreciation unless such depreciation is entered in the books of the company, recorded from time to time, seems to me without force. The books may be very badly kept, kept in such a way as will in the end bring them into trouble and difficulty; *but this act does not provide any penalty for bad bookkeeping.* It simply provides that one per cent.

of the net profit of the various corporations shall be turned over to the Government, and provides that in finding out that net profit there shall be a reasonable allowance for depreciation."

In *Baldwin Locomotive Works v. McCoach*, 215 Fed., 967, we find:

> "More actually insolvent business ventures have been made to appear nominally profitable by bad bookkeeping than in any other way. A manufacturing concern, for instance, which is a fit subject for proceedings in bankruptcy, may be made to show large nominal profits by the fraudulent expedient, or honest mistake, of charging repairs, which properly belong in the expense account, up to a machinery or other capital account and thus be made to figure as assets. By the reverse process of bad bookkeeping all profits may be made to disappear. Proper bookkeeping, therefore, involves in this respect the highest judgment, and 'profit' and 'loss,' 'capital' account become mere bookkeeping terms. * * * The observation applies to the bookkeeping act of how the books show that a particular piece of property possesses a certain value. The bookkeeping system or business policy may be adopted of charging up all the property acquisitions of the corporation at the cost price irrespective of any estimated value it may have. The policy may be adopted of having the book account follow all the variations and vagaries of the market."

In that case the corporation, at some time after the Act of 1909 was approved, caused its property to be re-valued, and entered upon its books certain properties which it had possessed but which had never theretofore been entered, resulting in a large increase in book assets. The Commissioner of Internal Revenue imposed an excise tax upon the basis of such book entries, asserting that the increased valuation thus shown was taxable income for the year in which it was made. This contention was overruled by the Court. We quote further from the opinion (page 971):

> "The first question to be determined, therefore, is whether the amount of net income is to be determined according to mere bookkeeping facts or according to the real facts

of gross income and the actual payments thereout for the purposes specified in the Act. This must be determined from the language employed by Congress. If the amount is to be determined by the mere bookkeeping facts, then it is difficult to escape the conclusion that we must take the facts from the books as kept, assuming, of course, their integrity and that they are kept in good faith. No other bookkeeper, governmental official or otherwise, could be permitted to manufacture a different set of bookkeeping facts for the plaintiff. If the amount is to be determined by the real facts, then a judicial inquiry must be made which will disclose them."

The decision in this case was afterward affirmed by the Circuit Court of Appeals for the Third Circuit in

McCoach v. Baldwin Locomotive Works, 221 Fed., 59.

Judge McPherson, writing the opinion of that Court, said:

"We agree with the District Court that this increase of valuation was not income within the meaning of the statute. Nothing whatever was added to the corporate property, which remained exactly the same after the appraisement as before. The only thing done was to put upon the company's books an expression of expert opinion that certain property was worth a certain sum, and this can hardly be said to be income, or even gain, in any proper sense. The company could not become either richer or poorer by making a few book entries that merely recorded a new estimate of how much it was worth."

A similar situation was presented, and determined in the same way, in

Industrial Trust Company v. Walsh, 222 Fed., 437.

In the case of *Forty Fort Coal Company v. Kirkendall,* 233 Fed., 706, a suit brought to recover an excise tax claimed to have been unlawfully exacted, where it was claimed by the defendant Collector that no depreciation account was kept upon the books and that the amount claimed for depreciation was carried on the books as surplus account, the Court said:

"It is not denied in the petition to set aside that the plaintiff's property was depleted to the amount of 15 cents for each ton of coal mined. *The sole ground of the Gov-*

ernment's claim is based on the book entry made in 1912 or 1913, and corrected in 1914. The decisions under the excise tax law and under the income tax law are uniform in effect that the Government cannot base a claim for taxes on mere bookkeeping. *Industrial Trust Company v. Walsh,* 227 Fed., 437; *Baldwin Locomotive Works v. McCoach,* 215 Fed., 967; *Id.,* 221 Fed., 59. In the latter case it was decided by the Circuit Court of Appeals for this Circuit that mere appraisement of property by a corporation on its books cannot form the basis of assessment of taxes on net income, even though the books show that during the tax year the value of the property was increased by the amount on which the government claims the regular rate of tax. The plaintiff here has admitted that during the year 1912 and 1913 a certain amount of money was carried on the books of the company in surplus account, but insists that such amount should have been properly noted on the books as depletion reserve. In the statement of claim, however, the truth of which is in no way disputed, it was specifically averred that the amount so temporarily shown on the books as surplus was not properly surplus, or net income, or profit, but was merely a return of capital asset, being an amount which represented the minimum value of the coal in the ground."

The foregoing quotations are convincing of the lack of either legal or practical foundation for the rule of the Department relied upon by the witness Schouler.

Chief Justice Waite, in considering the liability to taxation of a railroad company under the Act of Congress of July 14, 1870, imposing a tax of 2½% on profits not divided but used for construction, said:

> "This is to be ascertained, not by inquiry into the manner of keeping railroad accounts, but by interpreting the language of Congress at different times to give expression to its will; not by determining whether, as a matter of bookkeeping it is used to carry undivided profits used for construction to a construction fund, but by studying the several statutes to see if it was intended that, if so used, they should be taxed under the Act of 1870."
>
> *Marquette, H. & O. R. R. Co. v. United States,* 123 U. S., 722.

In the court below it was said in the same case (17 Fed., 721):

> "In bookkeeping, within the meaning of the Act of 1870, net earnings or undivided profits are added to a particular fund by proper transfer entries in the books of account. But the object of the statute is not defeated if profits used for construction are not carried into the proper account on the books; for, within the meaning of the statute, and according to common understanding and experience, they must be considered as added to construction fund, if they are used for construction."

We may, therefore, dismiss as unimportant the regulation of the Commissioner respecting the keeping of a book account of depletion or depreciation.

The Question of Depreciation is one of Fact.

The only consideration, then, is, as held in the cases just cited, and, with especial emphasis, in *Bailey v. Railroad Company*, 106 U. S., 109: What is *the actual fact* in relation to the diminution in value of the respondents' assets?

> "It is entirely consistent with the declaration itself to show, *in point of fact*, what was the amount of earnings accrued during the period while the Income Tax Act was in force, which had not been assessed for taxation as profits carried to construction or other account. *The declaration in the certificates could not be conclusive of anything not inconsistent with it, for an estoppel only prohibits contrary allegations.* The proof admitted on the trial below did not contradict the certificates but only served to rebut a presumption, which, as a matter of law, was not conclusive. Its tendency and effect were to exact from the company the full tax upon every dollar of its earnings which had not previously paid its proper assessment and which, in any form, was subject to taxation, and to relieve it only to the extent to which, otherwise, it would have been subjected to the payment of a second tax upon the same fund. This result and the process by which it was reached seem to us strictly to conform both to the letter and the spirit of the law governing the subject" (106 U. S., 117).

As pointed out by *Judge Dickinson* (215 Fed., 967, 969, 972), the provision in the Act of August 5, 1909, for a deduction by way of a reasonable allowance for depreciation, would not be justified were it not expressly mentioned, and, being expressly mentioned, it cannot be disregarded.

It is perfectly plain that, when the last ore shall have been mined and removed by their grantees from the lands of the respondent companies, and the last payment shall have been made under the contracts therefor, the substantial assets of the respondents will have become exhausted and the value which their capital stock had at the time of the transfer to the companies of the mineral properties, or at January 1, 1909, will have become entirely depleted. If that original value represented at any time the capital investment which the stockholders of the land companies owned, then it is manifest that, by the payments made under the contracts, the assets which gave value to their capital investment have been depreciated. If the capital assets have been depreciated, then their owners are, beyond peradventure, entitled to an allowance therefor. And since that depreciation arises, palpably, through the periodic payments upon the contracts constituting the assets, and since each payment produces a corresponding depreciation in capital value, it follows that the deduction authorized to be made to counteract that depreciation is exactly measured by the payments which caused it.

The income tax law approved September 8th, 1916, contains, in Section 12, the same provision for a reasonable allowance for depletion in the case of mines, and (repealing the hasty and ill-considered limitation thereon contained in the Act of October 3rd, 1913, generally regarded as unconstitutional) prescribes that such allowance shall not exceed "the market "value in the mine of the product thereof which has been mined "and sold during the year for which the return and computa-

"tion are made." This is not only the just allowance, but the only reasonable allowance which can be made, if exhaustion of natural deposits is to be compensated for.

It is an important fact in this legislation that the Congress has now recognized the true rights of property owners and has so legislated as to prevent further doubt or misconstruction respecting this reasonable allowance for depletion or depreciation.

We think it fair to assert that the enactment quoted was intended to be taken as an interpretation of the Congressional purpose respecting an allowance for depletion of natural resources, and to set at rest the controversies concerning it.

Attention is particularly directed to certain provisions of Section 10 of the Income Tax Law of September 8th, 1916. In defining, in that law, the term "dividends," the Congress provided that it shall be held to mean any distribution made by a corporation "out of its earnings or profits *accrued since March 1st, 1913*"; and, in the last paragraph of the same section, it has declared that, for the purpose of ascertaining the *gain* derived from the sale or other disposition by a corporation of its property acquired *before* March 1st, 1913, "the fair market "price or value of such property, as of March first, nineteen "hundred and thirteen, shall be the basis for determining the "amount of such gain derived or loss sustained."

Likewise, in Section 12, in respect of deductions to be made from the gross amount of corporate income, it is provided that, in the case of mines, a reasonable allowance for depletion thereof, not to exceed *the market value in the mine* of the product thereof which has been mined and sold during the year for which the return and computation are made, shall be deducted "provided, that, when the allowance authorized * * * "shall equal the capital originally invested, or, in case of pur- "chase made *prior* to March first, nineteen hundred and thir- "teen, *the fair market value as of that date*, no further allow-

"ance shall be made."

March 1st, 1913, was the date of incidence of the Income Tax Law of October 3rd, 1913, and, just as that law was attached to, and an enlargement of the Act of August 5, 1909, the Act of September 8th, 1916, is an extension of the former law. The provisions of the last named act, to which we have just referred, demonstrate clearly the understanding and intention of the Congress that property values then existing, regardless of original cost and without reference to any apportionment of increase during the years of ownership by a taxpayer, represented the capital investment of the taxpayer on March 1st, 1913. The Act also recognizes that the increment accruing up to the date named could not be taxed as income for the reasons already stated in this brief.

Now the same considerations apply with equal force to the operation and enforcement of the Excise Law of August 5th, 1909, and that only can serve as a basis for the excise tax which represents net income derived from earnings or profits accruing to a corporation *since January 1st, 1909;* or gains derived from the sale or other dispositions of property which, if it were acquired before January 1st, 1909, must be determined upon the basis of the fair market value of such property on that date.

It results that, if the gross receipts of the respondents from their mining contracts, instead of being deemed mere conversion of capital (as they contend is the case), are to be reckoned as "gross income," the allowance to them on account of the depreciation contemplated by the Act must be the amount by which the capital value of the contracts on January first, 1909, has been diminished, because the respondents have that much less receivable under the contracts.

Stratton's Independence, v. Howbert.

The case of *Strattons' Independence, Ltd., v. Howbert,* 231 U. S., 399, has been greatly relied upon, and singularly misconstrued, by the representatives of the Government in the cases which have arisen in the lower court under the Act of August 5, 1909, involving mining properties.

There is nothing in the opinion of this Court filed in that suit which destroys or conflicts with the contentions of these respondents. On the contrary, as far as it goes—and it, designedly, goes a very short way—it sustains their position fully.

It will be borne in mind that, in the cases at bar, the Government's claim has been that the *entire proceeds* derived by the respondents under the mining contracts for the disposition of the ore upon their lands represent gross income and embrace no sums representing return of capital assets, and the opinion in the *Strattons' Independence case* is relied upon to sustain this claim.

It is necessary, therefore, to examine that case with some care.

The plaintiff there was a gold mining corporation actively engaged in searching for, mining and removing ore found upon its own property, which it reduced in its smelter, afterwards selling the bullion derivative. Upon the trial of the case in the District Court, it was stipulated by the counsel for the respective parties as a fact, concerning which no further evidence was offered or received in the case, that the difference between the gross selling price of the ores and the cost of extracting, handling, smelting and selling the same was the value in place in said mine of such ores before the extraction thereof, and that no value was added to said ores so extracted and sold by and through the said operations, or any of them, in excess of the actual cost of such operation.

In an opinion filed by the trial judge, it was held: (1) That

the mining company was carrying on or doing business, and came within the scope of the Act; (2) that the *net receipts* derived from the working of the mine were the net *income* by which the excise tax of the company should be measured; and (3) that the company was not entitled to reduce the amount of the net receipts, as the basis for measuring the tax, by deducting any sum for depletion of capital assets. The case having been taken to the Circuit Court of Appeals for the Eighth Circuit, that Court certified the same to the Supreme Court and submitted for its opinion three questions, as follows:

> 1. Does Section 38 of the Act of Congress entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5th, 1909, apply to *mining corporations?*
>
> 2. Are the proceeds of ores *mined by a corporation from its own premises* income within the meaning of the aforementioned Act of Congress?
>
> 3. If the proceeds of ore sales are to be treated as income, is such a corporation entitled to deduct the value of such ore in place and before it is mined, as depreciation within the meaning of Section 38 of said Act of Congress?

The Supreme Court answered the first two questions in the affirmative and the third question in the negative; but an analysis of the opinion of the court discloses that, with the possible exception of the answer to the first question, the decision cannot be taken, and was not intended to be taken, as one of general application, but was confined exclusively to the individual case, leaving the questions open for further consideration by the Supreme Court on a fuller record, which will enable their complete examination.

The corporation in that case was a *mining company which operated its own mines,* and the inquiries of the Circuit Court of Appeals were confined to a corporation of that character, as was the reasoning and dicision of this court. *The respondent companies are not operating companies,* or engaged in any other

active business. As the court declared, *a mining corporation is actually engaged in business;* in its digging, tunneling, hoisting, treating and selling of ores, it employs both labor and capital in transmuting a part of its realty into personalty, processes equivalent to manufacturing. Nothing of the kind appertains to these defendants; they are not mining companies in any sense, but simply owners of mineral lands; they have no part in, or control over, the operations on their lands; the object of their organization and existence is simply to receive and distribute to their stockholders the receipts from the various contracts under which their ores were disposed of long before the law of 1909 came into existence. Such disposition is effecting, as the ores are mined, a sale of their mineral estates and a conversion of the same into money, and the transactions belong to the class particularly distinguished by the Supreme Court from the class which Stratton's Independence, Limited, illustrated when it declared, *the sale outright of a mining property "might be fairly described as a mere conversion of the capital from land into money"* (page 414).

Rarely is a decision seen in which so great care is taken not to seem to set a precedent; the court industriously limited its decision to the facts before it, and to the special cause in which they appeared. The operations of the company being "business," it necessarily followed, in the judgment of the court, that the revenue therefrom must be deemed gross income, since that was the end and aim of its peculiar business. There is an obvious analogy between such business and a life-estate in an opened mine, since the proceeds from sales of ore produced therefrom are the only income of which the business of operating a mine, like such a life estate, is capable; and in each case it is manifestly the only income contemplated. Not so, however, in the instance of a mere sale of mineral rights by a proprietor, to be exploited and won by the purchaser; in such case, "the sale outright of a mining property might be fairly

described as a mere conversion of the capital from land into money." "For," to quote again from *Mr. Justice Pitney,* "'income' may be defined as the gain derived from capital, from labor, or from both combined" (page 415). The respondent companies were not employing either capital or labor in any adventure, hence could derive no gain (or income) therefrom.

If Strattons' Independence, Limited, instead of working its own mine, had "leased" it to another corporation which had conducted the business of mining out the ore, it is manifest that both companies could not at the same time be carrying on or doing the business of its operation; one or the other of them would be liable to pay the excise tax therefor, *but not both.* Can there be any question as to which of them it would be? And since it is clear, under the *Howbert* decision, that the corporation which is operating must pay the tax, it is equally clear that the decision has no application in the case of the original proprietor, to fix the liability upon him also. Thus, in the instance of the respondents' properties, their "lessees" who may be extracting the iron ore have been required to pay the excise tax, and, by that very fact, the defendants are relieved from liability therefor. The "lessees" are taxable because they are carrying on and doing business for a profit. And this is justified and explained by *Mr. Justice Pitney,* in these words (page 416):

> "The conduct of such business [mining] results in profit, for it cannot be seriously contended that the ores are not worth more at the mine mouth than they were worth in the mine, plus the cost of mining."

The same reasoning that defines what is income, as respects the lessees, demonstrates that the purchase price paid by them for the ore in the ground represents, as respects the fee owners who have sold it, "a mere conversion of their capital from land into money." That, even in the case of a *mining* corporation *operating its own property,* a deduction for depletion of the natural deposits should be allowed *when properly ascertained,* was

declared by this Court, as has already been noted, at pages 417-18, viz:

> "Congress no doubt contemplated that such corporations, amongst others, were doing business with wasting capital, and for such wastage they made due provision in declaring that, from the gross income, there should be deducted (*inter alia*) 'all losses actually sustained within the year,' including 'a reasonable allowance for depreciation of property, if any,' etc."

This was again emphasized, at page 421, as follows:

> "It was, of course, contemplated that income might be derived from the employment of property in business, and that this property might become more or less exhausted in the process; and because of this, a reasonable allowance was to be made for depreciation of it, if any."

In the case of owners of mines *who are also operating them*, the "net *receipts*" from sales of ore are made up of two elements: one, the profit from mining; the other, the moneys representing the conversion of capital from ore into money, the propriety of the deduction for which, in arriving at the *net income*, is expressly recognized by the Act.

In the case of owners whose mines are operated by others, under a contract of sale or license, it is too clear to admit of discussion that some portion, if not all, of the royalties received must represent the value of the ore in place, and, as such, is converted capital.

In both cases it follows of necessity that only so much of the selling price or royalties as may be *in excess of the capital investment included in them*, is income which can be considered in assessing a tax based upon income; and it was for this reason that allowance for depletion of capital was expressly provided for in the Act.

It is evident then that this court did not decide, or intend to decide, in the *Strattons' Independence case*, that *all* of the moneys derived by an operating company from sales of ore, less only the expenses of operation, represented *net income* upon

the basis of which a tax must be paid; nor, in the case of fee owners who have sold their ores under contract to operating companies, that all of the moneys derived from such disposition is net income to them. *This court merely went so far as to express its dissent from the proposition that the difference between gross receipts of the disposition of ores, and the costs in connection with the mining and handling of the ores, represented the value of the ores in place in the mine.* As stated by *Mr. Justice Pitney*, at page 418, the question before the court was to be read "in the light of the issue that is presented to the Circuit Court of Appeals for determination, as recited in the certificate."

> "From that certificate it appears that the case was submitted to the trial court and a verdict directed upon an agreed statement of facts, and in that statement the gross proceeds of the sale of the ores during the year were diminished by the moneys expended in extracting, mining and marketing the ores, and the precise difference was taken to be the value of the ores when in place in the mine.
>
> "It is clear that a definition of the 'value of the ore in place' has been intentionally adopted that excludes all allowance of profit upon the process of mining, and attributes the entire profit upon the mining operations to the mine itself. In short, the parties propose to estimate the depreciation of the mining property attributable to the extraction of ores according to principles that would be applicable if the ores had been removed by a trespasser." (Pages 419-20).

Refusing to approve this mode of calculation, the court added (at the bottom of page 422):

> "It would, therefore, be improper for us at this time to enter into the question whether the clause 'and a reasonable allowance for depreciation of property, if any,' calls for an allowance on that account in making up the tax, where no depreciation is charged in practical bookkeeping; or the question whether depreciation, when allowable, may properly be based upon the depletion of the ore supply *estimated otherwise than in the mode shown by the agreed statement of facts herein;* that to do this would be to attribute a different meaning to the term 'value of the

ore in place' than the parties have put upon it, and to instruct the Circuit Court of Appeals respecting a question about which instruction has not been requested and concerning which it does not appear that any issue is depending before that court."

It is thus seen that the decisions of this court is not susceptible of the construction which has been urged for it in this and in other cases before the courts; that it was industriously confined to determining the matters presented to it by the certificate of the Circuit Court of Appeals, and that it specifically refused to express any opinion outside of the matters so presented. The only proposition of general application announced by the decision was that the net proceeds of the product of a mine operated by the owner do not represent converted capital alone but may include also some gain or income, and that the court will not sustain a contention to the contrary even though that contention be stipulated by the representatives of both parties to the suit,—at least where one of the parties is the Government and the question of Government revenue is directly involved.

The court did, however, in arriving at this conclusion, declare certain principles which may well be considered here. Thus, at page 415:

> "But when a company is digging pits, sinking shafts, tunneling, drifting, stoping, drilling, blasting, and hoisting ores, it is employing *capital* and labor in transmuting a part of the realty into personalty, and putting it into marketable form. The very process of mining is, in a sense, equivalent in its results to a manufacturing process, * * * the *gains* derived from it are properly and strictly the income from that business; for 'income' may be defined as the gain derived from capital, from labor, or from both combined, and here we have combined operations of capital and labor. * * * It is, of course, true that the revenues derived from the working of mines result, to some extent, in the exhaustion of the capital. * * * Although it may be foretold from the beginning that the manufacture will be profitable only for a limited time, at the end of which the capital value of the plant must be subject to

One additional suggestion may be permitted, namely: That the court in the *Stratton's Independence case* was considering only the status of a mining corporation *operating its own mines* —that is to say, the manufacturer and seller of the marketable product. The respondents in these cases occupied an entirely different situation. Undeniably, the mineral property, as originally owned by their grantors, was capital; when disposed of under the contracts, those contracts and the moneys payable thereunder were substituted therefor; the original owners did not attempt to manufacture the raw material as it existed in place in the mine, but disposed of it irrevocably, in consideration of certain specified payments of money, before the excise law was contemplated; the respondents took title to the property subject to such contracts; they did not mine the deposit; they did not convert it into merchantable ore; they did not sell the ore; they did not receive the proceeds of such sale, in which alone any gain, profit or income was embraced; and all of such income and gain, if any, was received by and belonged to their vendees, who have made their due returns and paid the excise tax based thereon.

There can be no doubt that the term "depreciation" as used in the Act was intended by Congress to carry its accustomed meaning. The word has, and from its deriviation can have, but one definition as employed in the act, namely: *reduction of worth* (Century Dictionary). It is impossible that Congress meant, in the connection in which the word is used, the restricted and technical meaning sometimes given to it, namely, loss of value occasioned by wear and tear, or obsolescence, as of machinery; or the reduction of worth in physical structures and improvements occasioned by accident, use, or action of the elements. As the term appears in the Act of August 5th, *it relates to all properties of every description*, whether structures erected by man, or natural mineral deposits, or contracts

calling for payments of money, making up the assets of taxable corporations; it embraces reduction in worth however occasioned, by diminution, depletion or exhaustion, as much as by wear and tear.

The question then, when reduced to its lowest terms and as applied to the facts in these cases, is:

Does a partial payment made upon an obligation of whatever kind, calling for the payment of money, reduce the worth of the obligation?

To ask the question is, of course, to answer it.

So long as the grantees, or lessees, who hold the mining contracts covering the respondents' lands, retain the same and fulfill their terms, those contracts are practically *bills receivable* in the hands of the respondent companies *and represent their interest in the mineral deposits.* All that the respondents can exact from their contractees is the payment of the moneys becoming due under the terms of the contracts. Although they are nominally the owners of the mineral properties, the properties are subject to the conditional contracts of sale, *and the moneys received by the respondents, under such contracts, are not receipts from conducting the business of mining, or from smelting ores, or from the sale of ores or metals, but are payments in reduction of the obligations evidenced by the contracts constituting their invested capital, and a mere change in the form of their corporate assets.* To that extent, the amount so received by the respondents is deductible from their gross receipts in any taxing year, if those gross receipts can be held to be gross income.

If the corporate owner of an interest in mineral deposits should dispose of it for a lump sum paid in cash, it is indisputable that such sum would represent its invested capital converted into another form; and, if such sum were thought to be gross income, to the extent that its mineral capital would be

depleted or depreciated by the sale, the corporation would become entitled to the deduction for depreciation provided for in the Act.

If, on the other hand, such owner should dispose of its mineral commodity for a stated price, payable in periodical instalments instead of cash, there would result, just as clearly, a disposal of capital assets, and the maturing payments, when made, would represent just as clearly the corporation's invested capital converted into another form. And, with equal certainty, to the extent to which that capital would be diminished by the payments received, such owner would become entitled to the deduction for depreciation allowed by the law, if, by any form of reasoning, the payments could be held to be gross income.

It cannot be said that, because payments are deferred, they lose their character of converted capital. It has never been considered that a partial payment upon the principal of a bill receivable does not represent the money invested therein; nor has it ever been asserted that the purchase money payable under an executory contract for the sale of land does not represent a conversion of capital assets when it is received by the vendor, nor that the value of the contract as an asset is not correspondingly depreciated.

It accordingly follows that, if this court should be of the opinion (and should so declare) that the moneys received by the respondents under their mining contracts can be deemed gross income in whole or in part, they are entitled to deduct therefrom, as the reasonable allowance for depreciation specified in the statute, the full amount of the moneys so received, upon the ground that they represent a mere transmutation of capital assets, being, in legal effect, the selling price of the respondents' rights in the mineral deposits which were a part of their capital on the first of January, 1909, and which, by virtue

of the mining contracts then outstanding, had been previously sold for the exact amounts of such receipts.

POINT V.

CONCLUSION.

It is respectfully submitted that the judgments of the Circuit Court of Appeals were right and should be affirmed.

November 20, 1916.

JOHN R. VAN DERLIP,
Counsel for Respondents,
906 Metropolitan Life Building,
Minneapolis, Minnesota.

BURT F. LUM,
KENNETH TAYLOR,
Associate Counsel.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1916.

No. 286.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

vs.

SARGENT LAND COMPANY, A CORPORATION.

No. 287.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

vs.

SUTTON LAND COMPANY, A CORPORATION.

No. 288.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

vs.

KEARSARGE LAND COMPANY, A CORPORATION.

OPINIONS REFERRED TO IN ARGUMENT.

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OPINIONS REFERRED TO IN ARGUMENT.

Decision.

(September 4, 1916.)

Dividends Declared or Assets Distributed Subsequent to March 1, 1913, from Profits Acquired Prior to that Date Do Not Constitute Taxable Income.

United States Circuit Court of Appeals, Eighth Circuit.

E. J. LYNCH, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MINNESOTA, PLAINTIFF IN ERROR,

vs.

HENRY TURRISH, DEFENDANT IN ERROR.

In Error to the District Court of the United States for the District of Minnesota.

Before Sanborn, Adams, and Carland, Circuit Judges.

Statement.

This writ of error was sued out to reverse a judgment which the plaintiff below, Turrish, recovered against Lynch the collector, for the return to him of $127.12, which the collector had assessed against him as an additional income tax under the Tariff Act of October 3, 1913, c. 16, Sec. II, 38 Stat. 166; 3 U. S. Comp. Stat. 1913, Secs. 6319, 6320, 6321, and which he had paid under protest. The facts were alleged in the plaintiff's complaint and admitted by demurrer. The Payette Lumber and Manufacturing Company was a corporation organized in 1903 with a capital stock of $1,500,000 divided into 15,000 shares of the par value of $100 each of which Turrish owned in 1913 and 1914 799¾ shares of the par value of $79,975. The Payette Company began immediately after its organization in 1903 to invest its capital in

timber lands in the State of Idaho and, prior to March 1, 1913, it had invested $1,375,000 thereof therein and the remainder thereof in other assets the ownership of which was incidental to the owning, holding and preservation of the timber lands. During this time it did no business except such as was incidental to the ownership and care of these lands and it made no dividends or payments of any kind to its stockholders. On March 1, 1913, the Payette Company still owned all the property and assets it had invested its capital in, and the value of these assets was not less than $3,000,000. The increase in the value of its property was due entirely to the gradual increase in the value of its timber lands between 1903 and March 1, 1913, and the value of the stock of Mr. Turrish was then twice its par value, or $159,950. In March, 1913, Mr. Turrish and all the other stockholders of the Payette Company gave an option in writing to purchase their stock for twice its par value. The holders of this option formed another corporation to which they transferred their option and that company preferred to purchase the property of the Payette Company to purchasing its capital stock. Thereupon, in December, 1913, that company offered to sell all its property to the Boise-Payette Company, the new corporation which held the option to purchase its stock, for $3,000,000 in cash on condition that the new company would assume its debts and liabilities. The offer was accepted and in March, 1914, the transaction was consummated. The Payette Company then had no assets but the $3,000,000 in cash and no liabilities not assumed by the Boise-Payette Company. It then distributed the $3,000,000 among its stockholders who surrendered their stock and the corporation had since been dormant. In the distribution of the proceeds of the property of the company Mr. Turrish received $159,950, which was twice the par value of his stock. The Commissioner of Internal Revenue deemed one-half of this sum, or the par value, and the actual value in 1903, of the stock of Turrish, capital returned to him, and the other half, or the

increase of the actual value of his stock between 1903 and March 1, 1913, by reason of the gradual advance during that time in the value of the timber lands of the Payette Company, income derived by him in 1914 from a dividend received from a domestic corporation subject to the income tax law. On this ground he assessed against Turrish an additional income tax of $127.12 on account of the second half of the $159,950. Turrish paid this tax under protest and brought this action for the return of the amount he paid. The court below was of the opinion that no part of this $159,950 was income taxable under the Act of October 3, 1913, and it accordingly overruled the demurrer and rendered judgment for the plaintiff.

SANBORN, *Circuit Judge, after stating the case above, delivered the opinion of the Court.*

Is the amount in excess of the par value, and of the actual value of his stock in 1903, derived by a stockholder of a domestic corporation subject to the Income Tax Law (38 Stat. 166, c. 16, Sec. II; 3 U. S. Comp. Stat. 1913, Secs. 6319, 6320, 6321), exclusively from the increase in the value of his stock prior to March 1, 1913, the effective date of that act, on account of the gradual advance in the value of the property of the corporation prior to that date, but first realized by him in cash by the distribution in 1914 by a dividend to all the stockholders of the corporation of all the proceeds of the sale in March, 1914, of all the property of the corporation, income, gains or profits of the stockholder taxable under that law? The negative answer to this question seems at first to be reasonable (1) because no income, gains or profits accrued to the stockholder during the year 1914, or after March 1, 1913; his property remained of the same value and gained nothing during that time and (2) because the sale of the property of the corporation in 1914 and the distribu-

tion of its proceeds to the stockholders was a mere change of the form, without increase of the value, of the property he owned before the Income Tax Law took effect. Counsel for the United States, however, contend that the $79,975 which measures the increase in the value of the stock of the plaintiff between 1903 and March 1, 1913, derived from the gradual advance during that time of the value of the timber land of the corporation is taxable as his income (1) because he had no interest in the increased value of the property of the corporation until the dividend which distributed the proceeds of the sale of its property was declared in 1914, (2) because upon this distribution and not before he first obtained an interest in this increased value and thus in 1914 for the first time, it became income to him, and (3) because this $79,975 was derived from a dividend received by him in 1914. To sustain the first two contentions counsel invokes the general rule that a stockholder has no legal title or right to the income, gains or profits of his corporation until the dividends of that income, or of those gains or profits, have been declared, and cites *Hyatt v. Allen*, 56 N. Y. 553, and like cases in support of that rule. But the tax authorized by the act under consideration is an annual tax on the income, gains or profits arising or accruing after March 1, 1913, in the calendar year preceding the levy, and neither the rule itself nor any rational application of it is determinative of the question in what year this alleged income accrued or arose, or of the question whether the proceeds of the dividend were income or capital. If it were, then the entire $159,950 would, by the same mark, have become his income, gains and profits when the distribution was made in 1914, for it was all distributed to him by the same dividend and until that dividend was declared he had no better legal title or right to any of the property of the corporation or to the proceeds of any of it than he had to the increased value of its timber land.

It is true that a corporation holds the legal title of, and the right to manage, control and convey its property and that a

stockholder is without that title and right. But, after all, the corporation is nothing but the hand or tool of the stockholders in which they hold its property for their benefit. They are the equitable and beneficial owners of all its property and it is the mere holder and manager of it for them. The benefit of every increase in the value of its property is their benefit and the injury of every decrease of the value of its property is their injury. They may by appropriate action at any time require and compel it to sell all its property and to distribute its proceeds among them, and may thus strip it of all its capital, all its income, surplus, gains and profits and leave it penniless. So in reality, as against its stockholders, a corporation has no, and they have all, the beneficial interest in its property. Every substantial increase in the value of its property immediately and proportionately increases the actual value of their stock and every substantial decrease of its value immediately and proportionately decreases the actual value of their stock. Whether the value of the property of a corporation is increased by a gradual advance through a series of years of the value of the same real or personal property held throughout, or by undivided income, gains or profits, the actual value of its stock is immediately and proportionately increased and the holders of that stock may at any time convey their respective beneficial interests in that enhanced value, in those undivided profits and in all the other property of the corporation by sale, gift or devise. *The Collector v. Hubbard*, 12 Wall. 1. The position that a stockholder in a corporation has no interest in the enhanced value of its property or in its undivided income, gains, profits or surplus until a dividend thereof is declared is untenable and may not prevail.

It is admitted by the demurrer that in this case the value of the property of the corporation increased solely by reason of the advance in the value of its timber lands from $1,500,000 in 1903 to $3,000,000 on March 1, 1913, that the value of the stock of the plaintiff from the same cause proportion-

ately increased from $79,975 in 1903 to $159,950 on March 1, 1913, and that no farther increase of value, gain, income or profit resulted before or by reason of the sale of all the property of the corporation in March, 1914, and the distribution of its proceeds among its stockholders.

The Income Tax Law of 1913 provides: "That there shall be levied, assessed, collected and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year a tax of 1 per cent. per annum." Par. A, Sub. 1.

> "In addition to the income tax provided under this section (herein referred to as the normal income tax) there shall be levied, assessed and collected upon the net income of every individual an additional income tax (herein referred to as the additional tax) of 1 per centum per annum." . . . "All the provisions of this section relating to individuals who are to be chargeable with the normal income tax, so far as they are applicable and are not inconsistent with this subdivision of Paragraph A, shall apply to the levy, assessment and collection of the additional tax imposed under this section." Par. A, Sub. 2.
>
> "That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise, or descent." Par. B.

After specifying the exemptions and deductions, allowed

in the computation of the net income for the purpose of levying the normal tax, the law declares that:

> "The said tax shall be computed upon the remainder of said net income of each person subject thereto, accruing during each preceding calendar year ending December thirty-first: Provided, However, That for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen, both dates inclusive."

All the value of the property of the corporation and all the value of the stock of the plaintiff, whether it was due to capital assets, or income, or gains, or profits, or all of these combined, had arisen and accrued and had become their property before March 1, 1913. Words in a statute ought not to be given a retrospective operation unless they are so clear, strong and imperative that no other meaning can be annexed to them or unless the intention of the legislature cannot be otherwise satisfied. *United States v. Burr*, 159 U. S., 78; *United States v. American Sugar Co.*, 202 U. S., 563, 577. The provisions of this law that the normal tax shall be levied annually upon the net income arising or accruing in the preceding calendar year, that so far as this case is concerned all the provisions relative to the levying of the normal tax shall apply to the levying of the additional tax, that the normal tax shall be computed on the remainder of the net income of each person accruing during each preceding calendar year ending December 31st, except that for the year ending December 31, 1913, it shall be computed on the net income accruing from March 1st to December 31st, leave no doubt that the Congress intended to and did exclude from the burdens of the taxes it imposed by the Income Tax Act of October 3, 1913, all income, gains and profits of every kind which had arisen or accrued prior to March 1, 1913. It clearly intended to leave and surely did leave all the income,

gains and profits which had accrued or arisen prior to that date whether they were in the form of divided or undivided surplus, income, gains or profits as free from every income tax it imposed and as absolutely the property of their respective legal and equitable owners as was any of their original capital or property. Now, the subsequent change by sale, distribution or otherwise of the form of property held on March 1, 1913, without thereby enhancing its value or causing any gain, profit or income to its holders, as from real to personal property, or from stock to cash, does not subject it to the income tax because it produces no gain, profit or income; it leaves the value of the property the same after as before the change. And as the sale of the property of the Payette Company in 1914 and the distribution of its proceeds to its stockholders by the dividend did not enhance the value of the property of the corporation or of the stockholders or produce any gain, profit or income for them, but left the value of their property the same that it was before those transactions and the same as it was when the Income Tax Law took effect, the declaration and payment in 1914 of the dividend by which the proceeds of the sale of the property of the corporation were distributed to its stockholders did not transform the increased value of the plaintiff's stock which had accrued and arisen prior to March 1, 1913, into income, gains or profits accruing or arising subsequent to that date and did not subject it to any income tax. *Merchants Ins. Co. v. McCartney,* 17 Fed. Cases 46, No. 9443; *Bailey v. R. R. Co.,* 22 Wall. 604, 106 U. S. 109, 114; *United States v. Smith,* 27 Fed. Cases 1175 No. 16, 341; *Von Baumbach v. Sargent Land Co.,* 219 Fed. 31, 36, 37, 134 C. C. A. 649, 654, 655; *Sargent Land Co. v. Baumbach,* 207 Fed. 423, 430, 432, 434; *Mitchell Bros. Co. v. Doyle,* 225 Fed. 437, 439, 440; *Doyle, Collector v. Mitchell Bros. Co.,* ..... C. C. A. ..... Fed. ..... (6th Circuit), filed June 30, 1916; *Chicago, Bur. & Q. R.*

Co. v. Page, 1 Biss. 461, 5 Fed. Cases 600, No. 2668; *Reynolds v. Williams,* 20 Fed. Cases 625, No. 11, 734, 4 Biss. 108.

The third argument of counsel for the collector is that because Paragraph B provides that: "The net income of a taxable person shall include gains, profits and income derived . . . from interest, rent dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever," all surplus or undivided profits included in any dividend received after March 1, 1913, although they accrued and aro. . years prior to that date, are by these terms of the law subjected to the additional tax, and he cites in support of this conclusion *Van Dyke v. City of Milwaukee,* 159 Wis. 460, 146 N. W. 812; and *United States v. Cleveland, C. C. and St. L. Ry. Co.,* a decision of the District Court of Ohio filed February 23, 1916. Conceding that these two decisions sustain this proposition of counsel for the government, they are not controlling and have not proved persuasive. In Van Dyke's case Judge Barnes filed an able dissenting opinion which has proved more convincing and which is in accord with the decision of the Supreme Court in *Gray v. Darlington,* 15 Wall. 63, and with the weight of authority. It was, as we have seen, the general purpose of Congress and the general effect of the Act of October 3, 1913, to impose an annual tax upon incomes, gains and profits accruing subsequent to March 1, 1913, and to impose none upon those which accrued or arose before that date. The interpretation of the clause of the act under consideration which brings within its grasp all incomes, gains and profits accrued before the effective date of the act which happen to form parts of dividends declared after that date flies in the teeth of the general purpose and policy of Congress in enacting the statute, creates an exception to the general effect of the statute which is not clearly made by the act itself and constitutes a strained and unnatural construction. Such a construction should not be adopted unless the terms of the act imperatively require it. The natural and

legal presumption is that Congress intended to treat all income, gains and profits accruing prior to March 1, 1913, alike and as it excluded from the burden of the income taxes all such income, gains and profits as accrued prior to March 1, 1913, that did not become parts of dividends declared after that date the presumption is that it intended to exclude those also. Not only is there nothing in the act to negative or overcome this presumption, but the terms of the law when carefully read sustain it. By the terms of the clause on which counsel relies the taxable net income there specified does not include all dividends received after March 1, 1913, or all proceeds of such dividends, but "gains, profits and income derived" from dividends. The clause is treating of the net income on which the additional tax is to be levied. By subdivision 2, Par. A, all the provisions of the section relating to individuals who are chargeable with the normal income tax, so far as they are applicable and are not inconsistent with that subdivision, are made to apply to the levy, assessment and collection of the additional tax. Two of the provisions of that section relating to individuals who are chargeable with the normal tax which are applicable to the levy, assessment and collection of the additional tax and are not inconsistent with the provisions of subdivision 2 are (1) that there shall be levied, assessed, collected and paid annually "upon the entire net income accruing from all sources in the preceding year a tax of one per centum per annum," and (2) that the tax shall be computed upon the remainder of net income "Accruing during each preceding calendar year ending December thirty-first: Provided, however, that for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen." All these provisions of the act must be read and construed together and when so read and interpreted there is no logical or rational way of escape from the conclusion that the "gains, profits and income derived"

from dividends charged with the additional tax by Par. B are the gains, profits and income arising and accruing subsequent to March 1, 1913, derived from dividends and those only. And the conclusion is that the proceeds of the enhanced value of the stock of the plaintiff which accrued and arose prior to March 1, 1913, from the gradual increase in the value of the timber land of the Payette Company and which formed a part of the dividend made by that company in 1914 was not subject to the additional income tax under the Act of October 3, 1913. This conclusion finds substantial support from another consideration. The words income, gains, profits are used in common parlance and as legal terms in contradistinction to capital, property, capital assets. The enhanced value of the land or property of a corporation or of the stock of a corporation which slowly accrues through a series of years from the natural and gradual increase of the value of the timber land or other property which the corporation holds without trading is more analogous to property, capital or capital assets than to income, gains or profits. It is rather a growth, an increase of the property or capital assets than income, gains or profits produced by the property. Adverting to the oft-quoted analogy declared by the Supreme Court of Georgia in *Waring v. Savannah*, 60 Ga. 100, that "The fact is, property is the tree, income is the fruit; labor is the tree, income the fruit; capital the tree, income the fruit," the enhanced value of property from the slow and gradual increase of its value through a series of years is rather a growth of the tree than the production of its fruit. It is so inequitable, so unjust, so discriminatory to treat such an enhanced value accruing through many years before the enactment of an income tax law as the income, gains or profits of the year in which it happens subsequently to be distributed that the following rule which is supported by the more forcible reasons and by the great preponderance of authority has become the established law in the federal courts. The enhanced value of property which accrues from the gradual in-

crease in its value during a series of years prior to the effective date of an income tax law, although divided or distributed by dividend or otherwise subsequent to that date does not become income, gains or profits taxable under such an act. Such enhanced value, like the property of which it is an outgrowth and in which it adheres, becomes the absolute property of its legal and equitable owners before the effective date of the law and as against such a law thereafter remains their capital assets. *Gray v. Darlington,* 15 Wall. 63, 65, 66, 67; *Sargent Land Co. v. Von Baumbach,* 207 Fed. 423, 432; *Von Baumbach v. Sargent Land Co.,* 219 Fed. 31, 36, 37, 134 C. C. A. 649, 654, 655; *Gauley Mountain Coal Co. v. Hays,* 230 Fed. 110; *Industrial Trust Co. v. Walsh,* 222 Fed. 437; *Mitchell Bros. Co. v. Doyle,* 225 Fed. 437, 439, 440; *Doyle v. Mitchell Bros. Co.,* C. C. A. , Fed. , (6th Circuit), filed June 3, 1916; *Hudson's Bay Co., Ltd., v. Stevens,* 25 L. I. R. 709, 5 Tax Cases 424, 436, 438, 439; *Tebrau (Johore) Rubber Syndicate, Ltd., v. Farmer,* 47 Scot. L. R. 816, 5 Tax Cases 658.

Because no income, gains or profits accrued to the plaintiff during the year 1914, or after March 1, 1913, but during that time his property remained of the same value and because the sale of the property of the Payette Company in 1914 and the distribution of its proceeds by a dividend to its stockholders was but a change of the form without any increase of the value of the property he owned before the Income Tax Law of 1913 took effect there was no error in the judgment below and it is affirmed. [Not yet officially reported.]

[Comment.]

The judgment of the Court below in Lynch *vs.* Hornby, which presented the same questions considered and determined in Lynch *vs.* Turrish, supra, and with which it was submitted, on the appeal of the Government, was affirmed, Judge Sanborn delivering the opinion of the Court. Filed September 4, 1916. [Not yet officially reported.]

Depletion of Natural Resources—Recording Depletion on Books.

Under the Corporation Excise Tax Law of 1909, the U. S. District Court, M. D. Pa., has held that a Coal Company was entitled to a deduction of 15 cents for each ton mined as an allowance for depletion. The fact that this amount was incorrectly carried on the books of the Company in surplus account instead of as depletion reserve did not justify the government in disallowing the deduction. (Forty Fort Coal Co. *v.* Kirkendall, Collector, 233 Fed. 704.)

UNITED STATES CIRCUIT COURT OF APPEALS,
EIGHTH CIRCUIT.

No. 4652, September Term, A. D. 1916.

E. J. LYNCH, *Collector of Internal Revenue for the District of Minnesota, Plaintiff in Error,*

vs.

H. C. HORNBY, *Defendant in Error.*

In Error to the District Court of the United States for the District of Minnesota.

Mr. Alfred Jaques, U. S. Attorney, appeared for plaintiff in error.

Mr. A. W. Clapp (Mr. N. H. Clapp, Mr. H. Oldenbur, and Mr. Harold J. Richardson, were with him on the brief), for defendant in error.

Before Sanborn, Adams, and Carland, Circuit Judges.

SANBORN, *Circuit Judge,* delivered the opinion of the court:

The writ of error in this case challenges a judgment which Hornby, the plaintiff below, recovered against Lynch, the collector, for the return to him of $171 which the collector had assessed against him as an additional income tax under the Tariff Act of October 3, 1913, C. 16, Sec. II, 38 Stat. 166; 3 U. S. Comp. Stat. 1913, Secs. 6319, 6320, 6321, and which he had paid under protest. The facts were alleged in the complaint of Hornby and they were admitted by demurrer. They are set forth in detail and are numerous, but the result of them is that Hornby was the owner of 434 shares of the capital stock of the Cloquet Lumber Company from 1906 until 1916. That company was a corporation of Iowa which for more than a quarter of a century has been engaged

in purchasing timber lands, manufacturing the timber into lumber and selling it. It had a capital stock of $1,000,000 divided into 10,000 shares of the par value of $100 each. On March 1, 1913, by the increase of the value of its timber lands and by its business operations it had become possessed of property which was worth four times the par value of its stock or $4,000,000, its timber had become worth ten dollars per thousand feet and the stock of Mr. Hornby, the par value of which was $43,400, had become worth at least $150,000. In the year 1914 the Cloquet Company was engaged in converting its standing timber into money and distributing it among its stockholders by cutting the timber, manufacturing it into lumber and selling the lumber. In that year it distributed to its stockholders in dividends $650,000. Of these distributions $240,000 or 24% of the par value of its capital stock was derived from the net earnings and profits of the company during the current period and $410,000 was derived from moneys realized during the year 1914 by the Cloquet Company from the conversion into money by it of property which it owned, or in which it had an interest, on March 1, 1913. Hornby received during the year 1914 $10,416 from the distribution of these net earnings and profits of the company and $17,794 out of the distribution of these moneys realized from the conversion into money of the property which the Cloquet Company owned or had an interest in on March 1, 1913. The property out of which the $410,000 was realized was of the value of $410,000 on March 1, 1913, and the conversion of it into money and the distribution thereof diminished the value of the Company's property as it was on March 1, 1913, by that amount and dimished the value of Mr. Hornby's stock as it was on March 1, 1913, and increased his cash $17,794. In his income tax return for the year 1914 Mr. Hornby included the $10,416 he received out of the income and profits of the Cloquet Company during that year and he paid an income tax without protest upon a computation which included this amount, but he did not include the $17,794 which he received out of the

moneys realized in 1914 by the Cloquet Company from the conversion into money of property which it owned or had an interest in on March 1, 1913. The Commissioner of Internal Revenue deemed this $17,794 taxable income to Mr. Hornby and on account of it levied an additional tax of $171 which Mr. Hornby paid under protest and brought this action to recover.

Counsel for the United States complains that the complaint does not state facts sufficient to constitute a cause of action because it does not state the original cost of the timber or other property which the Cloquet Company acquired before and owned on March 1, 1913. But that omission is immaterial because it does state the value of the property which that Company owned and was interested in on March 1, 1913, which was converted into money and distributed to its stockholders in 1914 and that this conversion and distribution diminished the value of its property as it was on March 1, 1913, and as it was just before the conversion and distribution by $410,000 and diminished the value of Mr. Hornby's stock as it was on March 1, 1913, and as it was just before the sale and distribution by $17,794. As none of the property which the Cloquet Company or Hornby held on March 1, 1913, whether it was original capital or previously earned surplus, income gains or profits, was intended to be made or was made taxable as income by the Income Tax Law of 1913, the complaint stated facts sufficient to show that this $17,794 was not so taxable.

This case was tried in the court below and was argued and submitted to this court with the case of Lynch *v.* Turrish, the opinion in which is filed herewith. With the exception of the contention which has just been considered it presents the same questions considered and determined in that case. For the reasons stated in the opinion in Lynch *v.* Turrish, and because no income, gains or profits accrued to Mr. Hornby during the year 1914, or at any time after March 1, 1913, by reason of the conversion into moneys and distribution in

the year 1914 of that portion of the property which the Cloquet Company owned or owned an interest in on March 1, 1913, from which it realized the $410,000 in 1914, but the effect of that conversion and distribution was simply to change the form in 1914 of a part of the property which Mr. Hornby owned on March 1, 1913, while its value remained the same, the $17,794 which he received in dividends from that conversion and distribution was not subject to any income tax under the Income Tax Law of 1913 and the judgment below is affirmed.

Filed September 4, 1916.

A true copy.

Attest:

[SEAL.] ——— ———,

Clerk U. S. Circuit Court of Appeals,
Eighth Circuit.

(32447)

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In the Supreme Court of the United States.

OCTOBER TERM, 1916.

FRED VON BAUMBACH, COLLECTOR OF Internal Revenue, petitioner, *v.* SARGENT LAND COMPANY.	No. 286.
FRED VON BAUMBACH, COLLECTOR OF Internal Revenue, petitioner, *v.* SUTTON LAND COMPANY.	No. 287.
FRED VON BAUMBACH, COLLECTOR OF Internal Revenue, petitioner, *v.* KEARSARGE LAND COMPANY.	No. 288.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF FOR PETITIONER.

STATEMENT OF THE CASE.

At some early time the Pillsbury brothers became the owners of large tracts of land in Minnesota (R. 44). After removing the timber they

sold undivided interests in the land, with a view of developing its ore deposits, to Bennett and Longyear (R. 45). Subsequently, and prior to 1902, the undivided interests of the Pillsburys passed, on their deaths, to their respective devisees, whose interests were in some cases as small as 216ths, and some of whom were minors (R. 45, 46). Under the laws of Minnesota a minor can not make a lease for more than 25 years (R. 46). As ore leases are usually made for a longer period, and as such small fractional interests prevented the efficient handling of the property, it was determined to form corporations and to issue to the owners so much stock therein as would exactly represent the undivided interest of each (R. 47). Because the amount of land owned was in excess of what the laws of Minnesota permitted one corporation to own (R. 47) these three respondent corporations were formed about February 20, 1906 (R. 1, 13, 25). The original articles of each provided (R. 8, Art. I):

> The general nature of its business shall be the buying, owning, exploring and developing, leasing, improving, selling and dealing in lands, tenements and hereditaments, and the doing of all things necessary or incidental to the things above specified.

This provision was amended December 29, 1909, to read (R. 3):

> The general purpose of the corporation is to unite in one ownership the undivided fractional interests of its various stock-

> holders in lands, tenements and hereditaments, and to own such property; and, for the convenience of its stockholders, to receive, and distribute among them the proceeds of any disposition of such property at such times, in such amounts, and in such manner, as the board of directors may determine.

Article X (after stating that the title to the property was in two classes (1) the heirs and devisees of the Pillsburys, and (2) Bennett and Longyear), recited (R. 10):

> this corporation having been formed, by mutual agreement of all said owners of both classes, for the more convenient handling, improvement, development and disposition of said properties, etc.

Prior to the organization of these corporations certain so-called mining leases had been made by the owners (R. 46), of which plaintiff's Exhibit 15 is a sample (R. 97, 98). Probably all the leases had been negotiated prior to the organization of the corporations (R. 50, 51), but one of the most important (plaintiff's Exhibit 16) was actually executed by the Sargent Land Company on January 2, 1907 (R. 50). These leases do not differ in any material respect from the ordinary form of mining lease used generally in this country. They "lease and demise" or "let and demise" certain lands for the purpose of exploring and taking out "the iron ore," "the merchantable iron ore" therein. One lease is for a term of 50 years, and the

other is until all merchantable ore grading 49 per cent and upward has been mined and shipped. In one lease the lessee agrees to pay " as rent or royalty " 25 cents a ton. In the other the lessee agrees to make graded payments of certain amounts per ton " as royalty." Both leases provide for minimum payments by the lessee in any event. Since the lessee is bound by elaborate stipulations to drill honestly for ore, to remove the ore in a proper manner, and to keep accurate accounts so that the royalty may be properly determined, the lessor reserves the right to enter on the land and drill for itself, also to inspect the workings; and the lessee is obligated to render daily and monthly statements as to the ore mined and the ore shipped. The leases contain the usual provisions as to the lessor's right to reenter and repossess on breach by the lessee of its agreements; they provide that tenants' fixtures shall not be removed; and a lien is reserved on the ore till it is sold.

The rights thus reserved to the lessor corporations they constantly exercised during the taxing years in question. They incorporated a company to inspect the operations of the lessees, and such inspections were regularly made (R. 55, 57–59). The controversy between the Kearsarge Land Company and the Oliver Mining Company, which appears on pages 77 to 80 of the record, is a fair example of the close attention and supervision given by these lessors to the operations of the lessees; and this was natural and necessary, since the amount

of their royalty depended on the extent to which, and the manner in which, the lessees mined the ore. In addition, the corporations did other things during the taxing years in question which space does not permit a rehearsal of. Their various activities are correctly set out by the district judge in his opinion (R. 115, 116).

After the passage of the corporation tax act the corporations claimed that they were not liable thereto because they were not doing business and had no income (R. 3). Being compelled to make a return, they filed one showing depreciation in excess of their gross income (R. 4, 5). The Government nevertheless assessed a tax upon them, the basis of which was the gross income from royalties, etc., deducting the items allowed by the act, e. g., expenses, taxes, etc. (R. 5, 107, 108). No allowance was made for depreciation, and none was claimed by the companies except for waste or depletion of capital (R. 107–112). No actual allowance or charge for such so-called "depreciation" was ever made by them on their books of account (R. 49, 108).

The companies paid the tax assessed and brought these actions to recover it. The district judge held that the companies were "doing business" within the meaning of the corporation-tax act. He held, however, that the rentals received were not income, but were return of capital, and rendered judgment for the full amount claimed by plaintiffs. (R.

113–124.) The Circuit Court of Appeals affirmed the judgment (219 Fed. 31), holding (*a*) that the companies had no income, since the payments were merely capital payments; (*b*) that a mining lease is not a lease at all, but a sale of the ore payable in installments, and hence the rentals are not income; (*c*) that the companies merely owned the right to the purchase price of the ore, as in the case of a person owning promissory notes payable in different years without interest, and that the annual payments could not be called income; (*d*) that the companies were not "doing business" within the meaning of the act.

ARGUMENT.

I.

THE RESPONDENTS WERE "DOING BUSINESS" WITHIN THE MEANING OF THE CORPORATION-TAX ACT.

This depends on whether the cases fall within *Mitchell* v. *Clark Iron Co.*, 220 U. S. 107, 170, or within *United States* v. *Emery, Bird, Thayer Realty Co.*, 237 U. S. 28.

In *Mitchell* v. *Clark Iron Co.* the bill of complaint alleged—

> that the company was incorporated under the laws of Minnesota (ch. 28, Laws 1876) and was authorized to own and hold real estate; that it was the owner of certain lands in Minnesota which it had explored for iron; * * *.

That the defendant Clark Iron Company some years ago made explorations for iron ore upon the lands hereinbefore described, or some portion thereof, and caused explorations and developments to be made thereon, resulting in the discovery of large bodies of iron ore in said premises, or some portion thereof.

That for more than three years last past the said lands upon which such deposits of iron ore have been discovered, have been leased to other parties or corporations for the purpose of carrying on mining operations thereon and taking out and removing iron ore, in consideration of the payment to the said defendant Clark Iron Company of rents or royalties based upon the iron ore so mined and removed, *and that for more than three years last past the said defendant Clark Iron Company has not engaged in any business other than to watch over and care for the said lands and receive the rents and royalties accruing therefrom and distribute the same to its stockholders by means of dividends,* except such business as has been necessary to transact in defending its title to the said premises, in which the said defendant has incurred large expense, the amount of which is unknown to this plaintiff, and that the only income the said defendant company has had for more than three years last past has been by way of rent and revenue from the said lands, accruing by and thru the leasing thereof for iron mining purposes

> by way of rental paid by the lessees on a royalty basis upon the iron ore mined and removed from said lands. [Italics ours.]

The case was tried on demurrer, so that these were the only facts before the court. This court, after stating these facts as to the nature of the business done by the company, said (220 U. S. 171):

> We think it is clear that corporations organized for the purpose of doing business, and actually engaged in such activities as leasing property, collecting rents, managing office buildings, making investment of profits, *or leasing ore lands and collecting royalties,* managing wharves, dividing profits, and in some cases investing the surplus, are engaged in business within the meaning of this statute, and in the capacity necessary to make such organizations subject to the law. [Italics ours.]

In the *Emery, Bird, Thayer Realty Company* case this court said (237 U. S. 32, 33):

> * * * The question is rather what the corporation is doing than what it could do, 228 U. S. 305, 306, but looking even to its powers they are limited very nearly to the necessary incidents of holding a specific tract of land. The possible sale of the whole would be merely the winding up of the corporation. That of a part would signify that the Dry Goods Company did not need it. *The claimants' characteristic charter function and the only one that it was carrying on was the bare receipt and distribution to its*

> *stockholders of rent from a specified parcel of land. Unless its bare existence as an intermediary was doing business, it is hard to imagine how it could be less engaged.* [Italics ours.]

The cases at bar fall directly within *Mitchell* v. *Clark Iron Company*. In that case it was alleged that all the leases had been made more than three years prior to the filing of the complaint, February 10, 1910, so that since the passage of the corporation-tax act the company had done nothing but watch over its lands and collect its royalties. The case is decisive here.

In the *Emery, Bird, Thayer Realty Company* case, while it is true that the corporation was carrying out the functions for which it was incorporated, those functions were purely passive. The corporation was a mere conduit pipe. It was as though it had been incorporated merely to collect the interest on investments, to receive income, so that it could be reached, not by an excise but only by an income tax. In the cases at bar the companies were incorporated for the very purpose of getting, in the operation and management of mining leases, the advantage of a legal person over minors and undivided interests. The corporations supplied the main capital—the land. The lessees supplied the labor and, so to speak, the working capital. The product was divided between them. This arrangement constituted a community of in-

terest between lessors and lessees and required the corporations to do what they did—namely, exercise a constant supervision over the business to see that they obtained their just royalties.

This is clearly brought out by the testimony of Bennett (R. 95, 96), that while sometimes ore lands or the ore itself are sold for a lump sum, the lessee prefers to pay a much larger sum as royalties to a smaller lump sum, because in the former way payments need not be made till the ore is marketed. This shows that the object of a mining lease is to divide up the mining business, the lessor furnishing most of the capital. It is not, therefore, like the case of a corporation leasing all of its property, including its franchises, and retiring from business, or the case of a corporation which merely receives ground rent from an investment. The facts as to "doing business" in the present cases are fully brought out in the opinion of the district judge (R. 115–117), and it seems impossible to add anything thereto.

II.

A MINING LEASE IS NOT A SALE ON INSTALLMENTS, AND THE ROYALTIES THEREON ARE INCOME.

(*a*) The Court of Appeals in deciding that a mining lease was a sale relied entirely upon a remark of Lord Blackburn in *Coltness Iron Co.* v. *Black,* 6 App. Cas. 315, 335, and on certain Pennsylvania cases (219 Fed. 38, 39). Lord Black-

burn, however, concluded the remarks quoted as follows:

> But the argument that no income tax should be imposed on what is, perhaps not quite accurately, called rent reserved on a mineral lease, because it is a payment by instalments of the price of minerals forming part of the land, any more than on the price paid down in one sum for the out and out purchase of the minerals forming part of the land, is, I think, untenable.

As to the Pennsylvania cases, the Court of Appeals failed to notice *Denniston* v. *Haddock,* 200 Pa. St. 426, 428, where the court, after referring to the cases relied on by the Court of Appeals, said of mining leases:

> Whether it would be better to call such an instrument accurately what it certainly was at common law, a lease without impeachment of waste, or to endeavor to reconcile all the decisions by calling it a conditional sale, is not necessary at present to discuss. The point to be noted is that the rules applicable to sales are not to be applied indiscriminately to such instruments, but each is to be construed like any other contract by its own terms.

Outside of the peculiar Pennsylvania cases, referred to by the Court of of Appeals, the authorities are uniform that a mining lease is not a sale and that the rents or royalties thereon are income. *United States* v. *Gratiot,* 14 Pet. 526, 538, 539; *Hyatt* v. *Vincennes Bank,* 113 U. S. 408, 416; *Ray-*

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Outside of the peculiar Pennsylvania cases, referred to by the Court of of Appeals, the authorities are uniform that a mining lease is not a sale and that the rents or royalties thereon are income. *United States* v. *Gratiot,* 14 Pet. 526, 538, 539; *Hyatt* v. *Vincennes Bank,* 113 U. S. 408, 416; *Ray-*

nolds v. *Hanna,* 55 Fed. 783, 800, 801; *Tenn. Oil, Gas & Mineral Co.* v. *Brown,* 131 Fed. 696, 700; *Browning* v. *Boswell,* 215 Fed. 826, 834; *Daly* v. *Beckett,* 24 Beav. 114; *The Queen* v. *Westbrook,* 10 Q. B. 178, 205; *Lacey* v. *Newcomb,* 95 Iowa, 287; *Hendrix* v. *McBeth,* 61 Ind. 473; *Comley* v. *Ford,* 65 W. Va. 429; *Eley's Appeal,* 103 Pa. St. 300; *McClintock* v. *Dana,* 106 *ib.* 386; *Shoemaker's Appeal, ib.* 392; *Gartside* v. *Outley,* 58 Ill. 210, 217; *Austin* v. *Huntsville Coal and Manufacturing Co.,* 72 Mo. 535; *Genet* v. *Delaware & Hudson Canal Co.,* 136 N. Y. 593, 601–606; *Ganter* v. *Atkinson,* 35 Wis. 48.

The case of *United States* v. *Gratiot, supra,* is not cited by the Court of Appeals and is really decisive of the question. Moreover, in the case of *Niles Land Co.* v. *Chemung Iron Co.* et al., 234 Fed. 294, this same Court of Appeals, though consisting of different judges, clearly held an instrument dealing with iron ore in Minnesota, precisely similar to plaintiff's Exhibits 15 and 16 in the present case, to be a lease.

It is said (219 Fed. 42) of some of these decisions that they arose under wills and depended therefore merely on the intent of the testator, but there were in them no special indications of the testator's intention, and he was merely presumed to have meant by royalties in mining leases what everybody else meant thereby.

(*b*) Prior to the time the rights of the United States accrued the Supreme Court of Minnesota had decided, in *State* v. *Evans,* 99 Minn. 220, that a mining lease is not a sale but a lease, and that

the royalties on it are true rents or profits accruing from the land, and this was affirmed in *Boeing* v. *Owsley,* 122 Minn. 190. Subsequently in the case of *State of Minnesota* v. *Royal Mineral Association,* 156 N. W. 128, the decision of the Court of Appeals in the present case was called to the attention of the Supreme Court of Minnesota, and that court declined to follow it, holding that the Pennsylvania decisions relied on by that court had been overruled; that the amounts stipulated to be paid by the lessees in mining leases were " rents," and were *taxable* as such. The decision in *State* v. *Evans* made a rule of property in Minnesota, and the Court of Appeals was bound to follow it. *Bucher* v. *Cheshire R. R. Co.,* 125 U. S. 555, 583; *Clarke* v. *Clarke,* 178 U. S. 186; *Abraham* v. *Casey,* 179 U. S. 210, 218; *East Cent. E. M. Co.* v. *Cent. Eureka Co.,* 204 U. S. 266, 272; *Kuhn* v. *Fairmont Coal Co.,* 215 U. S. 349, 360; *Foster* v. *Elk Fork Oil & Gas Co.,* 90 Fed. 178, 182; *York* v. *Washburn,* 129 Fed. 564, 567; *Fretts* v. *Shriver,* 181 Fed. 279.

It is contrary to all principle to have a mining lease of land in Minnesota called a sale if the question arise in the United States District Court for Minnesota, and a lease if it arise in a State court.

(*c*) If, then, these instruments were leases, and the royalties received by the corporations were " rent," there can be no doubt that such rentals, when received, constituted gross income of the lessors. Indeed *Mitchell* v. *Clark Iron Co., supra,*

is decisive on this point, since this court must have held, in order to render the decision it did in that case, that the royalties were income.

(*d*) If this court be disposed to consider the matter without reference to *Mitchell* v. *Clark Iron Co.*, the same conclusion must be reached. Whether these " royalties " are called payments by installment of a debt, or conversion of capital from one form to another, they were, nevertheless, received by the companies during the taxing years in question from the business done by them with the advantages inherent in a corporate organization. They were the gross income of the companies from such business, since gross income is nothing but gross money receipts or revenue. They are therefore within the very language of the act. *Anderson* v. *Forty Two Broadway Co.*, 239 U. S. 69. For this reason the two cases mainly relied on by the court of appeals are inapplicable.

In *Secretary of State* v. *Scoble*, (1903) 1 K. B. 494, (1903) A. C. 299, the Secretary of State for India purchased a railroad and exercised an option to pay for it in installments. It was held that these payments of a debt were not " profits and gains " for the year in which they were paid. This has no analogy to the periodical payments received in the present case in the regular course of the companies' business, and varying with the operation of that business. Hence the Lord Chancellor in the *Scoble case* distinguished it from the case of

an income tax on rent derived from coal (1903 A. C. 303). In *Stevens* v. *Hudson's Bay Co.*, 101 Law Times Rep. 96, it was distinctly held that the company in selling the lands was not engaged in a trade or business, and that if it had been engaged in selling lands as a business it would have been liable to the tax. So in *Gray* v. *Darlington*, 15 Wall. 63, 66, the majority of the court, in holding that the conversion of capital from one form into another was not gains, profits, or income of the year in which the conversion took place, pointed out that the rule would be different where the conversion took place in the regular course of business. This same distinction is thus clearly stated in *Stratton's Independence Limited* v. *Howbert*, 231 U. S. 399, 414, 415:

> * * * It is not correct, from either the theoretical or the practical standpoint, to say that a mining corporation is not engaged in business, but is merely occupied in converting its capital assets from one form into another. The sale outright of a mining property might be fairly described as a mere conversion of the capital from land into money. But when a company is digging pits, sinking shafts, tunneling, drifting, stoping, drilling, blasting, and hoisting ores, it is employing capital and labor in transmuting a part of the realty into personalty, and putting it into marketable form. The very process of mining is, in a sense, equivalent in its results to a manufacturing process. And,

> however the operation shall be described, the transaction is indubitably " business " within the fair meaning of the act of 1909; and the gains derived from it are properly and strictly the income from that business; for " income " may be defined as the gain derived from capital, from labor, or from both combined, and here we have combined operations of capital and labor. * * *

This view is adhered to in *Stanton* v. *Baltic Mining Co.,* 240 U. S. 103, 114, where it is said that a tax on the product of a mine " is not a tax upon property as such because of its ownership, but a true excise levied on the results of the business of carrying on mining operations."

The fact, therefore, that money is received by a corporation in satisfaction of some previously accrued right to its payment, or that it is received as one side of a conversion of capital, is not conclusive that it is not " gross income " under an excise tax measured by such income. If the money has been received in the regular course of a business carried on with the advantages inhering in corporate organization it falls within the terms of the act, and of course Congress had power to fix the measure of corporate advantage in business by money received from capital conversion, or money received in extinguishment of prior rights, as well as by any other rational system. *Society for Savings* v. *Coite,* 6 Wall. 594; *Prov. Inst.* v. *Mass.,* id. 611; *Ham. Co.* v. *Mass.,* id. 632; *Spreckels Sugar Refining Co.* v. *McClain,* 192 U. S. 397.

III.

THE RESPONDENTS ARE NOT ENTITLED TO ANY ALLOWANCE FOR "DEPRECIATION."

(A) "Depreciation" can not be "allowed" under the act unless, and only to the extent that, actual deductions or payments have been made on account of it.

This is clear on general principles. Just as "income" must be an actual, not a hypothetical, receipt, so "outgo" must be an actual, not a hypothetical, payment. Just as the appreciation in value of property, *e. g.* rise in value on the stock exchange, does not constitute "income," so depreciation in value, *e. g.* fall in value on the stock exchange, does not constitute "outgo." A terminable annuity, *e. g.* a pension, diminishes in value steadily as the period of its termination approaches, and yet no deduction can be made from its "income" on that account, unless a portion of said income is actually set aside for that purpose. The human machine is constantly wearing out, and yet no deduction can be made on that account, unless actual payments are made for insurance. The same is true of "capital" invested in patents, and of many other businesses. It can not be said that the man who allows his house to go to pieces, spending nothing for repairs, is yet entitled to the same deduction from his "income" as the prudent owner who spends enough from his income each year to keep his house in perfect condition.

Turning to the actual language of the act, it may be admitted that it is not entirely clear; but

ently, meant to give its sanction to this correct practice. The word "sustained" alone would have covered an estimated depreciation, and the intent of Congress in adding the word "actually" must have been to require some charging off of depreciation or some payment into a depreciation fund. This is the construction given to the phrase "losses actually sustained" in *Baldwin's Locomotive Works* v. *McCoach,* 215 Fed. 967, 969; 221 Fed. 59, and the same meaning should be placed on the phrase "a reasonable allowance for depreciation."

In addition, the act, when dealing with the return, provides that the corporation shall state "separately any amounts allowed for depreciation of property." This "allowance" must, of course, be made by the company itself and not by the taxing officials, and the language seems to point to some actual things done by the corporation in regard to "depreciation" and not to a mere estimate.

(B) Depletion of capital can not be deducted as "depreciation."

It may be admitted that under certain circumstances the term "depreciation" might be given a meaning broad enough to cover depletion of capital, but it seems certain that this is not its ordinary natural meaning. If a loaf of bread is eaten, no person would say that it had "depreciated." If a merchant has a stock of goods and he sells some

while others are damaged or affected by change of fashion, he certainly would not call the processes by the same name. In the case of a coal mine we say that the machinery, shafts, etc., depreciate, but we do not say that the coal depreciates by being sold. The hardship of the case, if any, should not be met by calling the process of sale something which it is not, namely, " depreciation."

The English decisions all seem to maintain, or, at least, countenance the view that depletion of capital can not be deducted as depreciation. *Lee* v. *Neuchatel Asphalt Co.* 41 Ch. Div. 1; *Wilmer* v. *McNamara & Co. Ltd.* (1895), 2 Ch. 245; *Coltness Iron Co.* v. *Black,* 6 App. Cas. 315; *Alianza Co.* v. *Bell* (1904), 2 K. B. 666 (1905), 1 K. B. 184 (1906), A. C. 18; *Kauri Timber Co. Limited* v. *Commr. of Taxes* (1913), A. C. 771, 777. In the latter case the Privy Council said:

> With regard to the decided cases, *the general principle* as to the impropriety of treating a quota of invested capital, or of the corpus of the subject acquired, as a proper item of debit from annual profits received, can no longer be considered to be in doubt. [Italics ours.]

In *Earl of Derby* v. *Aylmer* (1915), 31 Times Law Rep. 528, the question was whether, under the language of the act of 1878, section 12, the Earl of Derby was entitled to a deduction on account of the diminished value of a stallion for breeding

purposes owing to his increasing age. In holding that he was not the court said:

> That the diminished value was on the same footing as the investment of money in a waning source of income.

It is true that these cases go to some extent upon the peculiar language of the acts involved, but they appear also to be largely based upon the general principle that a depletion of capital is not a proper item of debit in an income account. The matter was squarely ruled in the way we contend for under the Civil War income-tax acts by the Commissioner of Internal Revenue (Boutwell on the direct and excise tax system of the United States, pp. 273, 274), and apparently this ruling was never questioned. In the case of *Stratton's Independence* v. *Howbert*, 207 Fed. 419, 421, 422, Judge Pope said:

> The ordinary definition of " depreciation " is the lessening of value. As applied to mining properties the word carries with it, as in the case of any other business, the idea of deterioration in visible improvements, such as mills and other surface structures and perhaps the underground improvements so far as they are put in by the hand of man, and therefore, speaking popularly, when we think of depreciation in mining properties, we think of a lessening in value by time, or perhaps by accident, of those physical elements which go to develop and to improve the property. Now, does this meaning, com-

monly entertained and accepted and which is common to every class of corporations, become enlarged in case of mining companies so as to make the extraction of ore likewise an element of depreciation? The court's view is that it does not. This conclusion is in part induced by the reasons which have been above discussed in connection with the term " net income " and in part by the peculiar nature of the mining business. This latter is sui generis. It lives by dying. It is a business that is intrinsically uncertain. The segregation of part of a stock of goods is a definite detraction from the whole. The excavation of a body of ore, however, may reveal other bodies and result in immeasurable increment. The taking out of ore, while in a sense depreciation from the body, very often leads to the revealing of still larger bodies, and thus results, not in a lessening of the value of the claim, but in a great increase in such value. Mining excavation, when properly conducted, is very often more a development than a waste or a detraction. As applied to this class of corporation, having as its purpose to exhaust—it may be a year hence or a hundred years hence—the body of ore for profit, the mere fact that ore may be extracted does not in my judgment make the value of such ore an element to be classed and deducted as a depreciation of the property. The court therefore holds, as to this second provision of the statute, that the extraction of ore does not constitute a credit in favor of

mining companies upon the account between them and the Government when this excise tax is to be assessed.

This same principle seems to be recognized by the Supreme Court of Pennsylvania in *Commonwealth* v. *The Ocean Oil Co.*, 59 Pa. St. 61; *Commonwealth* v. *Penn Gas Coal Co.*, 62 Pa. St. 241; and by the Supreme Court of Wisconsin in a recent decision under the income-tax act of that State. *Van Dyke* v. *City of Milwaukee*, 159 Wis. 460. On the other hand, no authority has been called to our attention where depletion of capital has been treated as "depreciation," except the decision of the court below and the decision of Judge Lacombe in the *Nipissing Mines* case, 202 Fed. 803.

CONCLUSION.

The judgment of the court below should be reversed and the cases ordered remanded to the district court with directions to enter judgments for the defendants.

WILLIAM WALLACE, Jr.,
Assistant Attorney General.

NOVEMBER, 1916.

O

In the Supreme Court of the United States.

OCTOBER TERM, 1915.

Nos.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, petitioner,

v.

SARGENT LAND COMPANY, A CORPORATION.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, petitioner,

v.

SUTTON LAND COMPANY, A CORPORATION.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, petitioner,

v.

KEARSARGE LAND COMPANY, A CORPORATION.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT, AND BRIEF IN SUPPORT.

To the Supreme Court of the United States:

The Solicitor General, on behalf of the United States, prays for writs of certiorari to review the judgments of the Circuit Court of Appeals for the Eighth Circuit in the above-entitled causes.

QUESTION PRESENTED.

The question presented is whether corporations, lessors in mining leases, are liable to pay a corporation tax on the royalties or rents received therefrom, under the provisions of section 38 of the act of Congress of August 5, 1909, 36 Stat. 11, 112.

THE FACTS.

At some early time the Pillsbury brothers became the owners of large tracts of land in Minnesota (R. 44). After removing the timber, they sold undivided interests in the land, with a view of developing its ore deposits, to Bennett and Longyear (R. 45). Subsequently, and prior to 1902, the undivided interests of the Pillsbury's passed, on their deaths, to their respective devisees, whose interests were, in some cases, as small as 216ths, and some of whom were minors (R. 45, 46). Under the laws of Minnesota a minor can not make a lease for more than 25 years (R. 46). As ore leases are usually made for a longer period, and as such small fractional interests embarrassed the efficient handling of the property, it was determined to form corporations, and to issue to the owners so much stock therein as would exactly represent the undivided interest of each (R. 47). Because the amount of land owned was in excess of what the laws of Minnesota permitted one corporation to own (R. 47), these three respondent corporations were formed about February 20,

1906 (R. 1, 13, 25). The original articles of each provided (R. 8):

> The general nature of its business shall be the buying, owning, exploring and developing, leasing, improving, selling and dealing in lands, tenements and hereditaments, and the doing of all things necessary or incidental to the things above specified.

This provision was amended December 29, 1909, to read (R. 3):

> "The general purpose of the corporation is to unite in one ownership the undivided fractional interests of its various stockholders in lands, tenements and hereditaments, and to own such property, and, for the convenience of its stockholders, to receive, and distribute among them the proceeds of any disposition of such property at such times, in such amounts, and in such manner, as the board of directors may determine."

Article X (after stating that the title to the property was in two classes (1) the heirs and devisees of the Pillsburys, and (2) Bennett and Longyear), recited (R. 10):

> this corporation having been formed, by mutual agreement of all said owners of both classes, for the more convenient handling, improvement, development and disposition of said properties * * *.

Prior to the organization of these corporations certain so-called mining leases had been made by the owners (R. 46), of which Plaintiff's Exhibit 15 is a

sample (R. 97, 98). Probably all the leases had been negotiated prior to the organization of the corporations (R. 50, 51), but one of the most important (Plaintiff's Ex. 16), was actually executed by the Sargent Land Company on January 2, 1907 (R. 50). These leases do not differ in any material respect from the ordinary form of mining lease used generally in this country. They "lease and demise" and "let and demise" certain lands for the purpose of exploring and taking out "the iron ore," "the merchantable iron ore" therein. One lease is for a term of 50 years, and the other is until all merchantable ore grading 49 per cent and upwards has been mined and shipped. In one lease the lessee agrees to pay "as rent or royalty" 25 cents a ton. In the other the lessee agrees to make graded payments of certain amounts per ton "as royalty." Both leases provide for minimum payments by the lessee in any event. Since the lessee is bound by elaborate stipulations to drill honestly for ore, to remove the ore in a proper manner, and to keep accurate accounts so that the royalty may be properly determined, the lessor reserves the right to enter on the land and drill for itself, also to inspect the workings; and the lessee is obligated to render daily and monthly statements as to the ore mined and the ore shipped. The leases contain the usual provisions as to the lessor's right to reenter and repossess on breach by the lessee of its agreements; they provide that tenants' fixtures shall not be removed, and a lien is reserved on the ore till it is sold.

The rights thus reserved to the lessor corporations they constantly exercised during the taxing years in question. They incorporated a company to inspect the operations of the lessees, and such inspections were regularly made (R. 55, 57–59). The controversy between the Kearsarge Land Company and the Oliver Mining Company, which appears on pages 77 to 80 of the record, is a fair example of the close attention and supervision given by these lessors to the operations of the lessees; and this was natural and necessary since the amount of their royalty depended on the extent to which, and the manner in which, the lessees mined the ore. In addition, the corporations did other things during the taxing years in question which space does not permit a rehearsal of. Their various activities are correctly set out by the district judge in his opinion (R. 115, 116).

After the passage of the Corporation Tax Act the corporations claimed that they were not liable thereto because they were not doing business, and had no income (R. 3). Being compelled to make a return, they filed one showing depreciation in excess of their gross income (R. 4, 5). The Government nevertheless assessed a tax upon them, the exact basis of which does not clearly appear in the record (R. 5, 107, 108). The record does show, however, that their claim for depreciation was based entirely on the annual depletion of capital from gradual waste of the ore supplies (R. 109), and that no actual allowance or charge for such so-called "depreciation" was ever made by them on their books of account (R. 49, 108).

bearing in mind the foregoing general principles, the weight of the reasoning is in favor of the construction we contend for. The strongest argument lies in the connection in which the term "depreciation" is found. The deduction permitted is:

> All losses *actually* sustained within the year * * * *including* a reasonable allowance for depreciation of property.

It seems clear, therefore, that "depreciation," as defined by the act, is within the class "losses *actually* sustained within the year"; and it seems equally clear that a loss to be "*actually* sustained" must have caused some actual disservice or damage to the person concerned. The mere depreciation of stocks on the exchange, of goods from damage, of a house from the weather, is not a loss "actually sustained" until in some way a payment has been made, or some analogous thing has been done which constitutes what is termed a "taking of the loss." Any other view will open the door to fraudulent or exaggerated estimates of losses by the taxpayer, and this is especially true of "depreciation." It is almost impossible to adopt any rule for *estimating* "depreciation" which shall apply to all businesses, and there is never any difficulty in obtaining the services of experts who will give as exaggerated an estimate of "depreciation" as the owner desires. As a matter of fact, most prudent business men do actually charge off annually a certain amount for "depreciation," and the act, appar-

122 Minn. 190. These decisions made a rule of property in Minnesota as to mining leases, which the Circuit Court of Appeals, under the decisions of this court, was bound to follow.

3. The decision of the Court of Appeals that the plaintiffs had no income, or were entitled to cancel it all by "depreciation," is contrary to the decision of this court in *Stratton's Independence, Limited*, v. *Howbert*, 231 U. S. 399.

4. The cases are of great public importance. Many suits are pending, or are about to be brought, to recover large amounts of taxes whose collection is claimed to be illegal for the same reasons asserted by the Circuit Court of Appeals in the present cases. Moreover, the same point will constantly arise under the Income Tax Act, for if, as held by the Circuit Court of Appeals, the corporations here had no income within the meaning of the Corporation Tax Act, equally individuals and corporations, lessors in mining leases, would have no income under the Income Tax Act, and the Government would be compelled to forego large amounts of taxes.

BRIEF IN SUPPORT OF THE PETITION.

I.

The respondents were "doing business" within the meaning of the Corporation Tax Act.

This depends on whether the cases fall within *Mitchell* v. *Clark Iron Co.*, 220 U. S. 107, 170, or within *United States* v. *Emery, Bird, Thayer Realty Co.*, 237 U. S. 28.

In *Mitchell* v. *Clark Iron Co.* the bill of complaint alleged that the company was incorporated under the laws of Minnesota (ch. 28, Laws 1876) and was authorized to own and hold real estate; that it was the owner of certain lands in Minnesota which it had explored for iron;

> That the defendant Clark Iron Company some years ago made explorations for iron ore upon the lands hereinbefore described, or some portion thereof, and caused explorations and developments to be made thereon, resulting in the discovery of large bodies of iron ore in said premises, or some portion thereof.
>
> *That for more than three years last past the said lands upon which such deposits of iron ore have been discovered, have been leased to other parties or corporations for the purpose of carrying on mining operations thereon and taking out and removing iron ore,* in consideration of the payment to the said defendant Clark Iron Company of rents or royalties based upon the iron ore so mined and removed, *and that for more than three years last past the said defendant Clark Iron Company has not engaged in any business other than to watch over and care for the said lands and receive the rents and royalties accruing therefrom and distribute the same to its stockholders by means of dividends,* except such business as has been necessary to transact in defending its title to the said premises, in which the said defendant has incurred large expense, the amount of which is unknown to this plaintiff,

> and that the only income the said defendant company has had for more than three years last past has been by way of rent and revenue from the said lands, accruing by and thru the leasing thereof for iron mining purposes by way of rental paid by the lessees on a royalty basis upon the iron ore mined and removed from said lands. [Italics ours.]

The case was tried on demurrer, so that these were the only facts before the court. This court, after stating these facts as to the nature of the business done by the company, said (220 U. S. 171):

> We think it is clear that corporations organized for the purpose of doing business, and actually engaged in such activities as leasing property, collecting rents, managing office buildings, making investments of profits, *or leasing ore lands and collecting royalties,* managing wharves, dividing profits, and in some cases investing the surplus, are engaged in business within the meaning of this statute, and in the capacity necessary to make such organizations subject to the law. [Italics ours.]

In the *Emery, Bird, Thayer Realty Company* case this court said (237 U. S. 32, 33):

> * * * The question is rather what the corporation is doing than what it could do, 228 U. S. 305, 306, but looking even to its powers they are limited very nearly to the necessary incidents of holding a specific tract of land. The possible sale of the whole would be merely the winding up of the corporation. That of a part would signify that the Dry

> Goods Company did not need it. *The claimants' characteristic charter function and the only one that it was carrying on was the bare receipt and distribution to its stockholders of rent from a specified parcel of land. Unless its bare existence as an intermediary was doing business, it is hard to imagine how it could be less engaged.* [Italics ours.]

It is submitted that the cases at bar fall directly within *Mitchell* v. *Clark Iron Company*. In that case, as stated above, it was alleged that all the leases had been made more than three years prior to the filing of the complaint, February 10, 1910, so that since the passage of the Corporation Tax Act the company had done nothing but watch over its lands, and collect its royalties. That case is decisive here.

In the *Emery, Bird, Thayer Realty Company* case, while it is true that the corporation was carrying out the functions for which it was incorporated, those functions were purely passive. The corporation was a mere conduit pipe. It was as though it had been incorporated merely to collect the interest on investments, to receive income, so that it could be reached, not by an excise, but only by an income, tax. In the cases at bar, the companies were incorporated for the very purpose of getting, in the operation and management of mining leases, the advantage of a legal person over minors and undivided interests. The corporations supplied the main capital—the land. The lessees supplied the labor and, so to speak, the working capital. The product was divided between them. This arrangement constituted a community

of interest between lessors and lessees, and required the corporations to do what they did, namely, exercise a constant supervision over the business to see that they obtained their just royalties. This is fully brought out in the opinion of the district judge (R. 115–117), and it seems impossible to add anything thereto.

II.

A mining lease is not a sale on installments, and the royalties thereon are income.

(*a*) The Circuit Court of Appeals in deciding that a mining lease was a sale relied entirely upon a remark of Lord Blackburn in *Coltness Iron Co.* v. *Black*, 6 App. Cas., 315, 335, and on certain Pennsylvania cases (219 Fed. 38, 39). But Lord Blackburn concluded the remarks quoted, as follows:

> But the argument that no income tax should be imposed on what is, perhaps not quite accurately, called rent reserved on a mineral lease, because it is a payment by instalments of the price of minerals forming part of the land, any more than on the price paid down in one sum for the out and out purchase of the minerals forming part of the land, is, I think, untenable.

As to the Pennsylvania cases, the Circuit Court of Appeals failed to notice *Denniston* v. *Haddock*, 200 Pa. St. 426, 428, where the court, after referring to the cases relied on by the Circuit Court of Appeals, said of mining leases:

> Whether it would be better to call such an instrument accurately what it certainly was at

> common law, a lease without impeachment of waste, or to endeavor to reconcile all the decisions by calling it a conditional sale, is not necessary at present to discuss. The point to be noted is that the rules applicable to sales are not to be applied indiscriminately to such instruments but each is to be construed like any other contract by its own terms.

Outside of the peculiar Pennsylvania cases, referred to by the Circuit Court of Appeals, the authorities are uniform that a mining lease is not a sale, and that the rents or royalties thereon are income. *United States* v. *Gratiot*, 14 Pet. 526, 538, 539; *Hyatt* v. *Vincennes Bank*, 113 U. S. 408, 416; *Raynolds* v. *Hanna*, 55 Fed. 783, 800, 801; *Tenn. Oil, Gas & Mineral Co.* v. *Brown*, 131 Fed. 696, 700; *Daly* v. *Beckett*, 24 Beav. 114; *Lacey* v. *Newcomb*, 95 Iowa, 287; *Hendrix* v. *McBeth*, 61 Ind. 473; *Comley* v. *Ford*, 65 W. Va. 429; *Eley's Appeal*, 103 Pa. St. 300; *McClintock* v. *Dana*, 106 *ib.* 386; *Shoemaker's Appeal*, *ib.* 392. In *Eley's Appeal*, *supra*, the court said (p. 306):

> The word "income" means the gain which accrues from property, labor or business. In its ordinary and popular meaning, it is strictly applicable to the periodical payments, in the nature of rent, which are usually made under coal and other mineral leases, and we have no doubt it was used in that sense by the testator.

The case of *United States* v. *Gratiot*, *supra*, is not cited by the Circuit Court of Appeals and is really decisive of the question.

It is said (219 Fed. 42) of some of these decisions that they arose under wills, and depended therefore merely on the intent of the testator, but there were in them no special indications of the testator's intention, and he was merely presumed to have meant by royalties in mining leases what everybody else meant thereby.

(*b*) Prior to the time the rights of the United States accrued the Supreme Court of Minnesota had decided, in *State* v. *Evans*, 99 Minn. 220, that a mining lease is not a sale but a lease, and that the royalties on it are true rents or profits accruing from the land, and this was affirmed in *Boeing* v. *Owsley*, 122 Minn. 190. That decision made a rule of property in Minnesota, and the Circuit Court of Appeals was bound to follow it.

Bucher v. *Cheshire R. R. Co.*, 125 U. S. 555, 583;

Clarke v. *Clarke*, 178 U. S. 186;

Abraham v. *Casey*, 179 U. S. 210, 218;

East Cent. E. M. Co. v. *Cent. Eureka Co.*, 204 U. S. 266, 272;

Kuhn v. *Fairmont Coal Co.*, 215 U. S. 349, 360;

Foster v. *Elk Ford Oil & Gas Co.*, 90 Fed. 178, 182;

York v. *Washburn*, 129 Fed. 564, 567;

Fretts v. *Shriver*, 181 Fed. 279.

It is contrary to all principle to have a mining lease of land in Minnesota called a sale if the question arise in the District Court for Minnesota, and a lease if it arise in a State court.

(c) It follows that the royalties or rents received by the respondent were income. The Circuit Court of Appeals refers as authority to cases where single sales of property have been held to be mere conversion of capital, but the judges who delivered those opinions were careful to state that the case of regular sales for a business are different. The rentals received on a lease of agricultural land or of a house necessarily represent, to some extent, a depletion of capital, and such leases may run so long that, unless replacement of capital be made, the property is worthless at the end of the term; but the rentals are nevertheless income. On this aspect of the case also *Mitchell* v. *Clark Iron Company, supra,* is decisive, for the court must have held in that case that the royalties on mining leases were income.

III.

The allowance as depreciation of all the receipts of royalties in excess of expenses was erroneous.

This follows necessarily from *Stratton's Independence, Limited,* v. *Howbert,* 231 U. S. 399, assuming that the respondents were "doing business," and had income. To say that they had income, but that, by deducting as depreciation the very items which constituted this income, they had none, is a *reductio ad absurdum.* There is no evidence in the record that the total amount of royalties received has any legitimate bearing on the amount of depletion of capital, figured either on a cost or on a value basis. The

opinion of the Circuit Court of Appeals went entirely on the ground that a mining lease is a mere sale on installments, and that everyone selling property on installments is entitled to deduct, *as depreciation*, the entire amount of the installment payments. The statement of such a proposition is its best answer, and, as to mining property at least, the case of *Stratton's Independence, Limited*, is decisive. Whatever the respondents may be entitled to deduct as depreciation, they are clearly not entitled, as matter of law, to deduct the entire amount of their net receipts.

IV.

It is respectfully submitted that the writs should issue as prayed.

JOHN W. DAVIS,
Solicitor General.

OCTOBER, 1915.

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In the Supreme Court of the United States.

OCTOBER TERM, 1915.

FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, Petitioner, *v.* SARGENT LAND COMPANY, A CORPORATION.	No. 707
FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, Petitioner, *v.* SUTTON LAND COMPANY, A CORPORATION.	No. 708
FRED VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, Petitioner, *v.* KEARSARGE LAND COMPANY, A CORPORATION.	No. 709

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

MOTION TO ADVANCE.

Comes now the Solicitor General, appearing on behalf of the petitioner, and respectfully moves the court to advance the above-entitled causes

The companies paid the tax assessed and brought these actions to recover it. The district judge held that the companies were "doing business" within the meaning of the Corporation Tax Act. He held, however, that the rentals received were not income, but were return of capital, and rendered judgment for the full amount claimed by plaintiffs. The Circuit Court of Appeals affirmed the judgment (219 Fed. 31), holding (*a*) that the companies had no income since the payments were merely capital payments; (*b*) that a mining lease is not a lease at all, but a sale of the ore payable in installments, and hence the rentals are not income; (*c*) that the companies merely owned the right to the purchase price of the ore, as in the case of a person owning promissory notes payable in different years without interest and that the annual payments could not be called income; (*d*) that the companies were not "doing business" within the meaning of the act.

REASONS FOR THE ALLOWANCE OF THE WRIT.

1. The decision of the Court of Appeals that the plaintiffs were not "doing business" is contrary to the decision of this court in *Mitchell* v. *Clark Iron Co.*, 220 U. S. 107, 170.

2. The decision of the Court of Appeals that a mining lease is a sale on installments is contrary to the decision of the Supreme Court of Minnesota—the State where the land lay, where the leases were made and were to be performed—in *State* v. *Evans*, 99 Minn. 220 (Sept. 1906), and *Boeing* v. *Owsley*,

The decision whether a corporation is carrying on business within the meaning of the Corporation Tax Law must depend in each instance upon the particular facts before the court; no particular amount of business is required.

A corporation which has not reduced its activities to owning and holding property and the distribution of its avails, but maintains its organization for continued efforts in pursuit of profit and for such activities as are therein essential, is carrying on business within the meaning of the act.

Respondent corporations, besides receiving and distributing among their shareholders the royalties from a number of outstanding long term "mining leases," employed another company to inspect the lessees' operations and keep them to their contracts, made some mining explorations at expense on other parts of their properties, sold or leased other parcels and sold some timber, *held*, that they were carrying on business within the meaning of the Corporation Tax Law.

Quære: Whether this court, in determining whether royalties under mining leases are income subject to the Corporation Tax Law, is constrained to follow the decisions of the highest court of the State in which the leased property is situate holding that such royalties are rents and profits.

The "mining leases" involved in these cases, were not equivalent to sales of property; and the moneys paid by the lessees to the respondents were not converted capital, but rents or royalties, and as such were income, proper to be included in measuring their taxes under the Corporation Tax Law. *Stratton's Independence* v. *Howbert*, 231 U. S. 399; *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103.

The depletion of a mine resulting from the removal of ore in the course of its operation is not a "depreciation of property" for which a deduction may be made under the Corporation Tax Law.

219 Fed. Rep. 31, reversed.

THE case is stated in the opinion.

Mr. Assistant Attorney General Wallace for petitioner: The respondents were "doing business" within the meaning of the Corporation Tax Act. The cases fall within *Mitchell* v. *Clark Iron Co.*, 220 U. S. 107, 170; not within *United States* v. *Emery, Bird, Thayer Realty Co.*, 237 U. S. 28. In the cases at bar the companies were

incorporated for the very purpose of getting, in the operation and management of mining leases, the advantage of a legal person over minors and undivided interests. The corporations supplied the main capital—the land. The lessees supplied the labor and, so to speak, the working capital. The product was divided between them. This arrangement constituted a community of interest between lessors and lessees and required the corporations to do what they did—namely, exercise a constant supervision over the business to see that they obtained their just royalties. This shows that the object of a mining lease is to divide up the mining business, the lessor furnishing most of the capital.

A mining lease is not a sale on installments, and the royalties thereon are income. See the full remarks of Lord Blackburn in *Coltness Iron Co.* v. *Black*, 6 App. Cas. 315, 335. As for the Pennsylvania cases relied on by the court below (219 Fed. Rep. 38, 39), see *Denniston* v. *Haddock*, 200 Pa. St. 426, 428; they oppose all the other authorities. Before the rights of the United States accrued, the Supreme Court of Minnesota had decided, in *State* v. *Evans*, 99 Minnesota, 220, that a mining lease is not a sale but a lease, and that the royalties on it are true rents or profits accruing from the land, and this was affirmed in *Boeing* v. *Owsley*, 122 Minnesota, 190, and in *Minnesota* v. *Royal Mineral Association*, 156 N. W. Rep. 128, notwithstanding the decision below. The decision in *State* v. *Evans* made a rule of property in Minnesota, and the Court of Appeals was bound to follow it.

The royalties or rentals, when received, constituted gross income of the lessors. *Mitchell* v. *Clark Iron Co.*, *supra*. Whether these "royalties" are called payments by installment of a debt, or conversion of capital from one form to another, they were, nevertheless, received by the companies during the taxing years from the business done by them with the advantages inherent in a corporate

organization. They were the gross income of the companies from such business, since gross income is nothing but gross money receipts or revenue. They are therefore within the very language of the act. *Anderson* v. *Forty-two Broadway Co.*, 239 U. S. 69. The distinction is plain between a casual conversion of capital, *Secretary of State* v. *Scoble* (1903), 1 K. B. 494 (1903) A. C. 299; *Stevens* v. *Hudson's Bay Co.*, 101 Law Times Rep. 96; *Gray* v. *Darlington*, 15 Wall. 63, 66, and a conversion occurring in the regular course of business. *Stratton's Independence, Ltd.*, v. *Howbert*, 231 U. S. 399, 414, 415; *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103, 114.

"Depreciation" cannot be "allowed" under the act unless, and only to the extent that, actual deductions or payments have been made on account of it. Just as "income" must be an actual, not a hypothetical, receipt, so "outgo" must be an actual, not a hypothetical, payment. It seems clear that "depreciation," as defined by the act, is within the class "losses *actually* sustained within the year;" and it seems equally clear that a loss to be "*actually* sustained" must have caused some actual disservice or damage to the person concerned. *Baldwin Locomotive Works* v. *McCoach*, 215 Fed. Rep. 967, 969; 221 Fed. Rep. 59.

Depletion of capital cannot be deducted as "depreciation." The latter term does not naturally include the former. In the case of a mine the machinery, shafts, etc., depreciate, but we do not say that the deposit of mineral depreciates by being sold. The English decisions all seem to maintain, or, at least, countenance the view that depletion of capital cannot be deducted as depreciation. *Lee* v. *Neuchatel Asphalt Co.*, 41 Ch. Div. 1; *Wilmer* v. *McNamara & Co., Ltd.* (1895), 2 Ch. 245; *Coltness Iron Co.* v. *Black*, 6 App. Cas. 315; *Alianza Co.* v. *Bell* (1904), 2 K. B. 666 (1905), 1 K. B. 184 (1906), A. C. 18; *Kauri Timber Co., Ltd.*, v. *Commr. of Taxes* (1913), A. C. 771, 777. See

Boutwell on the direct and excise tax system of the United States, pp. 273, 274; *Stratton's Independence* v. *Howbert*, 207 Fed. Rep. 419, 421, 422; *Commonwealth* v. *Ocean Oil Co.*, 59 Pa. St. 61; *Commonwealth* v. *Penn Gas Coal Co.*, 62 Pa. St. 241; *Van Dyke* v. *Milwaukee*, 159 Wisconsin, 460. We know of no authority holding depletion of capital equivalent to "depreciation" other than the decision of the court below and that in the *Nipissing Mines Case*, 202 Fed. Rep. 803.

Mr. John R. Van Derlip, with whom *Mr. Burt F. Lum* and *Mr. Kenneth Taylor* were on the brief, for respondents.

The respondents were not corporations "organized for profit." The sole purpose of their organization was the liquidation of the assets contributed, in undivided portions, by the owners, with a view to the partition of the whole and to enable them to realize the money equivalent of their respective contributions, but with no view to dealing, speculating, trading, or gain. The act means that a corporation, to be subject to taxation, must be organized to make profit from the carrying on or doing of business. *Lewellyn* v. *Pittsburgh, B. & L. E. Ry. Co.*, 222 Fed. Rep. 177, 183, 184; *Smith* v. *Anderson*, L. R., 15 Ch. Div. 247. The words "organized for profit," do not merely distinguish between charitable corporations and all others. The suggestion that any corporation organized by private persons for their own advantage or interest is organized for profit is untenable. Such an interpretation is opposed to the common acceptation of the words, and renders them idle. For it is not sensibly conceivable that any persons would organize a corporation, unless it would be of some advantage to them. The tax is not a tax on incomes, nor on corporations which merely receive incomes from property. *Zonne* v. *Minneapolis Syndicate*, 220 U. S. 187; *McCoach* v. *Minehill &c. R. R. Co.*, 228 U. S. 295; *Flint* v. *Stone-Tracy Co.*, 220 U. S. 149, 152. The receipt of inter-

est, rent, or other income is simply a concomitant of property ownership. *Pollock* v. *Farmers' Loan & Trust Co.*, 158 U. S. 601, 625, 626. "Profit" in this act signifies the gain from a commercial or other active business, involving "ordinary and necessary expenses" in the way of rentals, salaries and other outgoes and obligations. *Gray* v. *Darlington*, 15 Wall. 63; *People* v. *Board of Supervisors*, 4 Hill, 20. If the words "organized for profit" be ignored, the act would apply to every corporation carrying on or doing business, which, concededly, it does not.

Respondents were not "carrying on or doing business" during the years for which the tax was assessed. There was no substantial activity other than the receipt of moneys payable to them under the outstanding mining contracts and the distribution of such moneys to their stockholders. It was only because the act was limited to corporations doing business that its constitutionality was sustained. *Flint* v. *Stone-Tracy Co., supra.*

In *Mitchell* v. *Clark Iron Co.*, 220 U. S. 107, 170, the question whether the Clark Iron Company was "doing business" within the meaning of the statute was not an issue. This court assumed that the company was continuing, after the passage and approval of the act, to make leases from time to time, an activity, which, if it existed, may be conceded to be doing business within the statute.

The amendment of the articles of incorporation in these cases conforms completely in its effect to the amendment made by the Minneapolis Syndicate in the *Zonne Case, supra*, and also in *Abrast Realty Co.* v. *Maxwell*, 206 Fed. Rep. 333; *s. c.*, 218 Fed. Rep. 457.

In every case the question is determined not by the power to act, but by the activities engaged in by the corporation. *Flint* v. *Stone-Tracy Co.*, 220 U. S. 107, 145, 151; *United States* v. *Emery, Bird, Thayer Realty Co.*, 237 U. S. 28, 32; *Minehill &c. R. R. Co.* v. *McCoach*, 192

Fed. Rep. 670, 672; *Public Service Ry. Co.* v. *Herold*, 227 Fed. Rep. 500; *State Line Co.* v. *Davis*, 228 Fed. Rep. 246, 249.

Owning and caring for property and division of the income from it is not "doing business." Business must be actually done. So far as concerns the mining property, the contracts disqualified respondents from "doing business." The business was all done by the lessees. The petty licenses to squatters and the two or three sales of burned timber to save its value from destruction were of course merely incidental and negligible. So were the sales of land, which were trivial, incidental to ownership and made under a contract antedating respondents' ownership. Sales, or receipts of principal, interest or rents, as incidents of ownership, are not doing business.

Since the receipts of money under the mining contracts represented merely a conversion of capital assets without gain or profit, they were not "gross income." Respondents took and held the legal title, subject to the outstanding contracts, pursuant to which they could receive, and anticipate receiving, nothing except the moneys which should become payable thereunder. Even if the contracts were not sales of the ore, it does not follow that the receipts were income. Counsel here distinguished English cases, and cited *Caldwell* v. *Fulton*, 31 Pa. St. 475; *Harlan* v. *Lehigh C. & N. Co.*, 35 Pa. St. 287; *Citizens' Gas Co.* v. *Whitney*, 232 Pa. St. 592, and many other Pennsylvania decisions, and *Hook* v. *Garfield Coal Co.*, 112 Iowa, 210; *Wilson* v. *Youst*, 43 W. Va. 826; *Selvey* v. *Grafton Coal Co.*, 72 W. Va. 680; *Manning* v. *Frazier*, 96 Illinois, 279. The contracts are analogous to executory contracts of sale. *Genet* v. *D. & H. Canal Co.*, 136 N. Y. 593; *Browning* v. *Boswell*, 215 Fed. Rep. 826; *Kansas Natural Gas Co.* v. *Board*, 75 Kansas, 335.

The decisions of the Minnesota Supreme Court on the nature of such "mining leases" are not binding as a rule of

property or otherwise. All the cases cited to the contrary concerned private disputes in most instances governed by local laws or rules of property, and in none of them was the construction of a federal statute involved. The law in question is a federal taxing law which under the Constitution must operate with uniformity to be valid, and in applying it the federal courts must follow their own judgment.

Gross income and gross receipts are different things. There is no tax unless there are net profits. *Flint* v. *Stone-Tracy Co.*, 220 U. S. 145. If the receipts from the leases were income there would be no distinction under the act between income and "property or invested capital."

That proceeds of sales of capital are not income, see: *Stevens* v. *Hudson's Bay Co.*, 101 L. T. Rep. 96; *Secretary of State for India* v. *Scoble*, 89 L. T. Rep. 1; *Baldwin Locomotive Works* v. *McCoach*, 215 Fed. Rep. 967, 969.

That is capital which is owned by a taxpayer at the time of the incidence of the tax, and to the extent of its value at that time, money into which the property is afterward converted, is not to be considered as income which can form the basis of taxation.

The respondents were entitled to deduct the amount of the royalties as "a reasonable allowance for depreciation of property," under the act. Omission to enter them in a depreciation account was not material, and the Commissioner's regulation to the contrary was an unlawful extension of the act. The question of depreciation was one of fact. *Bailey* v. *Railroad Company*, 106 U. S. 109. As a fact the capital value of the contracts, as it was when the act took effect, was diminished by the amount of the subsequent payments. This was "depreciation," under the act. See the Income Tax Law of September 8, 1916, §§ 10 and 12, 39 Stat. 756.

Stratton's Independence v. *Howbert* is consistent with the foregoing propositions.

MR. JUSTICE DAY delivered the opinion of the court.

These three cases were argued and submitted together and involve practically the same facts. Suits were brought by the corporations named in the United States District Court for the District of Minnesota against the Collector of Internal Revenue, to recover certain taxes, paid under protest, assessed under the Corporation Tax Law of 1909, 36 Stat. 11, 112, for the years 1909, 1910 and 1911. The judgments in the District Court were for the respondents (207 Fed. Rep. 423), which judgments were affirmed in the Circuit Court of Appeals. 219 Fed. Rep. 31.

In 1890, John S. Pillsbury, George A. Pillsbury and Charles A. Pillsbury, doing business together as John S. Pillsbury & Company, were the owners of large tracts of lands in northern Minnesota, which had been acquired for the timber and from which the timber had been cut, being valuable after such severance of the timber for the mineral deposits contained therein. In the year named, the Pillsburys entered into an arrangement with John M. Longyear and Russell M. Bennett, authorizing the latter two to explore the lands for iron deposits. In 1892, Longyear and Bennett having discovered valuable deposits of iron ore, a half interest in something over ten thousand acres of the lands was conveyed to them, the lands thereafter being owned by the Pillsburys, John, George and Charles, each an undivided sixth, and John M. Longyear and Russell M. Bennett each an undivided fourth. In the year 1901, the Pillsburys having died, these corporations were formed under the laws of Minnesota. In 1906, the ownership of these leased lands was vested in the three corporations named as respondents in the proceedings. As originally organized, the nature of the business was stated to be "the buying, owning, exploring and developing, leasing, improving, selling and dealing in, lands, tenements and hereditaments, and the doing of all things

necessary or incidental to the things above specified." In December, 1909, the articles of incorporation were amended to read as follows: "The general purpose of the corporation is to unite in one ownership the undivided fractional interests of its various stockholders in lands, tenements and hereditaments, and to own such property, and, for the convenience of its stockholders, to receive, and distribute to them, the proceeds of any disposition of such property at such times, in such amounts, and in such manner, as the board of directors may determine."

All of the mining leases, hereinafter mentioned, with the exception of a contract with the Van Buren Mining Company, were executed before the organization of the corporations. Each of these instruments provided that the owners of the property demised to the lessees, exclusively, all the lands covered by the descriptions for the purpose of exploring for, mining and removing the merchantable iron ore which might be found therein for and during the period named, usually fifty years. The lessees were given exclusive right to occupy and control the demised premises and to erect all necessary buildings, structures and improvements thereon. Right was reserved to the lessors to enter for the purpose of measuring the amount of ore mined and removed and making observations of the operations in the mines. The lessees agreed to pay, in most cases, twenty-five cents per ton for all ore mined and removed, and to make such payments monthly for ore mined and shipped during the preceding month. The lessees agreed to mine and ship a specified quantity of ore in each year, and, in default of this, to pay the lessors for the minimum amount specified, and take credit therefor and apply such sums upon ore mined and shipped thereafter in excess of such minimum. The lessees were to pay the taxes and to keep the property free from encumbrances and liens. Right was reserved to

terminate the contract upon the failure of the lessees to comply with the terms thereof.

The form of the leases is shown in Exhibits 15 and 16, which were not in the printed record, owing to their length, but copies of which, pursuant to stipulation, have been sent to this court. An examination of Exhibit 16 shows that the lessees had the right to terminate and surrender the lease by giving the lessors, or those having their estate in the premises, sixty days' written notice, and executing sufficient conveyances releasing all interest and right of the lessees in the premises with any improvements thereon, and surrendering the same in good order and condition, etc., and that thereupon all liability of the lessees to taxes subsequently assessed on the demised premises or for rent thereof thereafter to accrue, or royalty on ores therefrom except on account of ores removed, should cease and determine; the lessees to be liable for all ores removed from the premises not theretofore paid for, and to pay for the premises rent or royalty for the year in which termination should be made, or the portion thereof which should have expired, at the rate of $12,500.00 per annum.

Since their organization the corporations have disposed of certain lands and have also disposed of the stumpage on some timber lands. Certain parcels were rented and leased, and a village was allowed to use part of the land for schoolhouse purposes, as well as another part for a public park.

To insure the proper carrying on of the mining operations, the companies employed another corporation, engaged in engineering and inspection of ore properties, to provide supervision and inspection of the work upon the respondents' properties, for which the inspecting company was paid from month to month, as statements were rendered.

The companies were assessed upon their gross income,

for joint hearing on a day convenient to the court at the next term.

These are suits brought by the above-named respondents to recover taxes claimed to have been erroneously collected under the provisions of the Corporation-Tax Act. The question presented is whether corporations, lessors in mining leases, are liable to pay a corporation tax on the royalties or rents received therefrom, under the provisions of section 38 of the act of Congress of August 5, 1909, 36 Stat. 11, 112. The determination of the question by this court will control the disposition of a number of cases where taxes were collected under similar circumstances.

Opposing counsel concur in this motion.

JOHN W. DAVIS,
Solicitor General.

APRIL, 1916.

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VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, *v.* SARGENT LAND COMPANY.

VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, *v.* SUTTON LAND COMPANY.

VON BAUMBACH, COLLECTOR OF INTERNAL REVENUE, *v.* KEARSARGE LAND COMPANY.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

Nos. 286, 287, 288. Argued December 13, 14, 1916.—Decided January 15, 1917.

Corporations organized under the laws of Minnesota, not for charitable or eleemosynary purposes but for the pecuniary advantage of their shareholders, *held*, "organized for profit" within the meaning of the Corporation Tax Law of August 5, 1909.

being the entire receipts of the companies from royalties on the leases collected in the years 1909, 1910, and 1911, and some sums received from the sales of lots, lands and stumpage, from which expenses and taxes were deducted, but no deduction was made upon account of the depletion of the ore in the properties, or on account of such sales.

The brief for the respondents states that these cases present for consideration four questions, which are:

"1. Are the respondents corporations organized for profit?

"2. Were the respondents carrying on or doing business during the years 1909, 1910, 1911?

"3. Were moneys received by the respondents during those years in payment for iron ore, under the contracts covering their mineral lands, gross income, or did they represent, in whole or in part, the conversion of the investment of the corporations from ore into money?

"4. If such moneys were gross income, are the respondents entitled to make any deduction therefrom on account of the depletion of their capital investment?"

As to the first question, whether these corporations were organized for profit, there can be no difficulty. They certainly do not come within the exceptional character of charitable or eleemosynary organizations excepted from the operation of the act. We need not dwell upon the obvious purpose of these corporations, organized under the provisions of the Minnesota statute concerning companies organized for profit, to pursue gain and to profit because of their operations.

As to the second question: were the respondents carrying on business, within the meaning of the Corporation Tax Act? This question was dealt with by this court in the first of the Corporation Tax Cases, *Flint* v. *Stone-Tracy Company*, 220 U. S. 107. As the tax was there held to be assessed upon the privilege of doing business in a corporate capacity, it became necessary to inquire what

it was to do business, and this court adopted with approval the definition, judicially approved in other cases, which included within the comprehensive term "business" "that which occupies the time, attention and labor of men for the purpose of a livelihood or profit."

In that case a number of realty and mining companies were dealt with, and the Park Realty Company, organized to deal in real estate, and engaged at the time in the management and leasing of a certain hotel, was held to be engaged in business. It was also held that the Clark Iron Company, organized under the laws of Minnesota, and owning and leasing ore lands for the purpose of carrying on mining operations, and receiving a royalty depending upon the quantity of ore mined, was engaged in business.

At the same time, and decided with the main Corporation Tax Case, this court held, in the case of *Zonne* v. *Minneapolis Syndicate*, 220 U. S. 187, that a corporation which owned a piece of real estate which had been leased for 130 years, at an annual rental of $61,000, and which had amended its articles of incorporation so as to limit its purposes to holding the title to the property mentioned, and, for the convenience of its stockholders, to receiving and distributing from time to time the rentals that accrued under the lease and the proceeds of any disposition of the land, was not engaged in doing business within the meaning of the act, by reason of the fact that the corporation had practically gone out of business and had disqualified itself from any activity in respect thereto.

The act next came before this court in the case of *McCoach, Collector*, v. *Minehill & Schuylkill Haven R. R. Co.*, 228 U. S. 295, in which it was held, distinguishing the case of the Park Realty Company, *supra*, and applying the case of *Zonne* v. *Minneapolis Syndicate*, *supra*, to the facts before the court, that a corporation which had leased all its property to another, and was doing only what was necessary to receive and distribute the income therefrom

among stockholders, was not doing business within the meaning of the act.

In *United States* v. *Emery, Bird, Thayer Realty Co.*, 237 U. S. 28, this court held that a corporation which merely kept up its organization, distributing rent received from a single lessee, was not doing business within the meaning of the act.

It is evident, from what this court has said in dealing with the former cases, that the decision in each instance must depend upon the particular facts before the court. The fair test to be derived from a consideration of all of them is between a corporation which has reduced its activities to the owning and holding of property and the distribution of its avails and doing only the acts necessary to continue that status, and one which is still active and is maintaining its organization for the purpose of continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes.

From the facts clearly established in these cases, we think these corporations were doing business, within the meaning of the act. They were organized for the purposes stated, and their activities included something more than the mere holding of property and the distribution of the receipts thereof. As was found by the District Court, the evidence shows that these three companies sold, during each of the years named, quantities of real estate, and the same were not small. They sold stumpage from some of the properties which had been burned over, leased certain properties in the village of Hibbing, and granted leases to squatters. One of the companies made explorations and incurred expenses in the matter of test pits. They employed another company to see that the mining operations were properly carried on, and that the lessees lived up to the engagements of their contracts. "All these things indicate," said the learned District Judge, "the doing of and engaging in business. It [the corporation] was doing

the business of handling a large property, selling lots, and seeing that the lessees lived up to their contracts. If that is not engaging in business, I do not know what is." We agree that it certainly was doing business, and, as the Corporation Tax Act requires no particular amount of business in order to bring a company within its terms, we think these activities brought the corporations in question within that line of decisions in this court which have held such corporations were doing business in a corporate capacity within the meaning of the law.

Next, is it true, as contended by the Government, that the payments for ore mined, under the contracts covering the mineral lands, are income, within the meaning of the act; or do they represent the conversion of the investment of the corporations from ore into money?

The nature of these mining leases has been the subject of some difference of opinion in the courts. The Circuit Court of Appeals in this case took the view announced in some of the earlier cases, notably in Pennsylvania, that the leases were such in name only, and were in fact conveyances of the ore in place as part of the realty, and that the so-called royalties merely represented payments for so much of the land and were in no just sense income, but mere conversions of the capital.

These lands are situated in Minnesota, and this character of lease has long been familiar in that State, as a means of securing the development and operation of mining properties. Some years before the passage of the Corporation Tax Act, the Supreme Court of Minnesota had dealt with the character of such instruments. In the case of *State* v. *Evans*, 99 Minnesota, 220, that court, after a review of the English and American cases, said (p. 227):

"The propriety of a lease for the purpose of developing and working mines is recognized by all of the cases, and the rule established by the great weight of authority that such leases do not constitute a sale of any part of the land,

and, further, that iron or other materials derived from the usual operation of open mines or quarries, constitute the rents and profits of the land, and belong to the tenant for life or years, and to the mortgagor after sale on foreclosure, and before the expiration of the time for redemption. The rule, however, has no application to unopened mines in the absence of a contract, express or implied, for opening and leasing them."

The same doctrine was held in *Boeing* v. *Owsley*, 122 Minnesota, 190, and in the late case of *State* v. *Royal Mineral Association*, 132 Minnesota, 232, in which the decision of the Circuit Court of Appeals in this case, that such leases were merely conveyances of the ore in place, was brought to the attention of the court, and that conclusion expressly denied, the Supreme Court of Minnesota saying:

"We adhere to the doctrine of the *Evans* and *Boeing Cases*, and hold these instruments leases. It follows logically that the amounts stipulated to be paid by the lessees are rents, and they were expressly held by this court to be rents in the *Boeing Case, supra*, a case which involved a construction of the very leases now before the court. They are 'the compensation which the occupier pays the landlord for that species of occupation which the contract between them allows.' Lord Dennison, in *Queen* v. *Westbrook*, 10 Q. B. 178, 205."

These conclusions of the Supreme Court of Minnesota are not only made concerning contracts in that State, such as are here involved, but are supported by many authorities.[1] Ordinarily, and as between private parties, there

[1] *Raynolds* v. *Hanna*, 55 Fed. Rep. 783, 800, 801; *Tennessee Oil &c. Co.* v. *Brown*, 131 Fed. Rep. 696, 700 (opinion by Lurton, J.); *Browning* v. *Boswell*, 215 Fed. Rep. 826, 834; *Backer* v. *Penn Lubricating Co.*, 162 Fed. Rep. 627; *Young* v. *Ellis*, 91 Va. 297; *Gartside* v. *Outley*, 58 Ill. 210; *Genet* v. *Delaware and Hudson Canal Co.*, 136 N. Y. 593, 602; *Lacey* v. *Newcomb*, 95 Iowa, 287; *Austin* v. *Huntsville Coal & Mining Co.*, 72 Mo. 535; *Brown* v. *Fowler*, 65 Ohio St. 507, 521; *Queen* v. *Westbrook*, 10 Q. B. 178, 205.

is no question of the duty of the federal court to follow these decisions of the Minnesota Supreme Court, as a rule of real property long established by state decisions. *Kuhn* v. *Fairmont Coal Company*, 215 U. S. 349, 360. Whether in considering this federal statute we should be constrained to follow the established law of the State, as is contended by the Government, we do not need to determine. The decisive question in this case is whether the payments made as so-called royalties amount to income so as to bring such payments within the scope of the Corporation Tax Act of 1909. The prior decisions of this court in *Stratton's Independence* v. *Howbert*, 231 U. S. 399, and *Stanton* v. *Baltic Mining Company*, 240 U. S. 103, in which the *Stratton Case* was followed and approved, are decisive of this question. In the *Stratton Case*, certain questions were certified to this court from the Circuit Court of Appeals for the Eighth Circuit. The case was tried upon an agreed statement of facts, from which it appeared, "as to the year 1909, that the company extracted from its lands during the year certain ores bearing gold and other precious metals, which were sold by it for sums largely in excess of the cost of mining, extracting, and marketing the same, that the gross sales amounted to $284,682.85, the cost of extracting, mining and marketing amounted to $190,939.42, and 'the value of said ores so extracted in the year 1909, when in place in said mine and before extraction thereof, was $93,743.43.' With respect to the operations of the company for the year 1910, the agreed facts were practically the same, except as to dates and amounts. It does not appear that the so-called 'value of the ore in place,' or any other sum, was actually charged off upon the books of the company as depreciation." The Circuit Court of Appeals certified three questions to this court: "I. Does Section 38 of the Act of Congress, entitled 'An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes,'

approved August 5, 1909 (36 Stat., p. 11), apply to mining corporations? II. Are the proceeds of ores mined by a corporation from its own premises income within the meaning of the aforementioned Act of Congress? III. If the proceeds from ore sales are to be treated as income, is such a corporation entitled to deduct the value of such ore in place and before it is mined as depreciation within the meaning of Section 38 of said Act of Congress?" This court answered the first and second questions certified in the affirmative, and the third question in the negative. In that case, as here, it was contended that the proceeds of the mining operations resulting from a conversion of the capital represented by real estate into capital represented by cash are in no true sense income. As to this contention, this court said:

"The peculiar character of mining property is sufficiently obvious. Prior to development it may present to the naked eye a mere tract of land with barren surface, and of no practical value except for what may be found beneath. Then follow excavation, discovery, development, extraction of ores, resulting eventually, if the process be thorough, in the complete exhaustion of the mineral contents so far as they are worth removing. Theoretically, and according to the argument, the entire value of the mine, as ultimately developed, existed from the beginning. Practically, however, and from the commercial standpoint, the value—that is, the exchangeable or market value—depends upon different considerations. Beginning from little, when the existence, character and extent of the ore deposits are problematical, it may increase steadily or rapidly so long as discovery and development outrun depletion, and the wiping out of the value by the practical exhaustion of the mine may be deferred for a long term of years. While not ignoring the importance of such considerations, we do not think they afford the sole test for determining the legislative intent."

This court held that it was not correct to say that a mining corporation was not engaged in business, but was merely occupied in converting its capital assets from one form to another, and that while a sale outright of a mining property might be fairly described as a conversion of the capital from land into money, the process of mining is, in a sense, equivalent to a manufacturing process, and however the operation shall be described, the transaction is indubitably "business" within the meaning of the Act of 1909, and the gains derived from it are properly the income from business, derived from capital, from labor, or from both combined. Further, "as to the alleged inequality of operation between mining corporations and others, it is of course true that the revenues derived from the working of mines result to some extent in the exhaustion of the capital. But the same is true of the earnings of the human brain and hand when unaided by capital, yet such earnings are commonly dealt with in legislation as income. So it may be said of many manufacturing corporations that are clearly subject to the act of 1909, especially of those that have to do with the production of patented articles; although it may be foretold from the beginning that the manufacture will be profitable only for a limited time, at the end of which the capital value of the plant must be subject to material depletion, the annual gains of such corporations are certainly to be taken as income for the purpose of measuring the amount of the tax."

It is contended that this case is inapplicable, because the facts disclose that the ores were being mined by a corporation upon its own premises. In our view, this makes no difference in the application of the principles upon which the case was decided. We think that the payments made by the lessees to the corporations now before the court were not in substance the proceeds of an outright sale of a mining property, but, in view of the

terms of these instruments, were in fact rents or royalties to be paid upon entering into the premises and discovering, developing and removing the mineral resources thereof, and as such must be held now as then, to come fairly within the term income as intended to be reached and taxed under the terms of the Corporation Tax Act.

In *Stanton* v. *Baltic Mining Company, supra,* the Income Tax Law of 1913 was before the court, and it was contended that the clause in that act, limiting the mines to a maximum depreciation allowance of five per cent. of their annual gross receipts or output of ore deposits, was unconstitutional, or, if that provision was inseparable from the rest of the act, the entire Income Tax Law, as applied to mining companies, was unconstitutional. Replying to the argument advanced by the mining company in that case, this court said that it rested upon the wholly fallacious assumption that, looked at from the point of view of substance, a tax on the product of a mine was necessarily a tax upon the property because of its ownership unless adequate allowance be made for the exhaustion of the ore body resulting from the working of the mine; and, further,

"We say wholly fallacious assumption because independently of the effect of the operation of the Sixteenth Amendment it was settled in *Stratton's Independence* v. *Howbert,* 231 U. S. 399, that such a tax is not a tax upon property as such because of its ownership, but a true excise levied on the results of the business of carrying on mining operations."

We think it results from the principles announced in these decisions that in such cases as are now under consideration, the corporation being within the meaning of the act organized for profit and doing business, it is subject to the tax upon its income derived from the royalties under these leases.

This brings us to the fourth and last question in the case, as to whether allowance should be made for deprecia-

tion on account of the depletion of the property by removing the ores from the mines in question.

The contention of respondents in this behalf is, that if the court shall find that the moneys received by them under their mining contracts can be deemed gross income, in whole or in part, they are entitled to deduct therefrom, as a reasonable allowance for depreciation, the full amount of the money so received, for the reason that they represent a mere transmutation of capital assets, being, in legal effect, the selling price of their rights in the mineral deposits on or before January 1, 1909, and which, by virtue of the mining contracts then outstanding, had been previously sold for the exact amounts of such receipts.

The statement of facts in the case of *Stratton's Independence, supra*, as the court states on pages 418 and 419, developed from the certificate, was:

"From that certificate it appears that the case was submitted to the trial court and a verdict directed upon an agreed statement of facts, and in that statement the gross proceeds of the sale of the ores during the year were diminished by the moneys expended in extracting, mining, and marketing the ores, and the precise difference was taken to be the value of the ores when in place in the mine. . . .

"It is clear that a definition of the 'value of the ore in place' has been intentionally adopted that excludes all allowance of profit upon the process of mining, and attributes the entire profit upon the mining operations to the mine itself. In short, the parties propose to estimate the depreciation of the mining property attributable to the extraction of ores according to principles that would be applicable if the ores had been removed by a trespasser."

It is true that in the case of *Stratton's Independence, supra*, the decision upon the question of depreciation was predicated upon the facts stated in the certificate presented to the court, and it was said, at page 422:

"It would therefore be improper for us at this time to enter into the question whether the clause, 'a reasonable allowance for depreciation of property, if any,' calls for an allowance on that account in making up the tax, where no depreciation is charged in practical bookkeeping; or the question whether depreciation, when allowable, may properly be based upon the depletion of the ore supply estimated otherwise than in the mode shown by the agreed statement of facts herein; for to do this would be to attribute a different meaning to the term 'value of the ore in place' than the parties have put upon it, and to instruct the Circuit Court of Appeals respecting a question about which instruction has not been requested, and concerning which it does not appear that any issue is depending before that court."

It therefore follows that we have the question of depreciation in this case presented under somewhat different circumstances than were outlined in the opinion in the case of *Stratton's Independence*.

The statute permits deduction of "all losses actually sustained within the year . . . including a reasonable allowance for depreciation of property." What was here meant by "depreciation of property"? We think Congress used the expression in its ordinary and usual sense as understood by business men. It is common knowledge that business concerns usually keep a depreciation account, in which is charged off the annual losses for wear and tear, and obsolescence of structures, machinery and personalty in use in the business. We do not think Congress intended to cover the necessary depreciation of a mine by exhaustion of the ores in determining the income to be assessed under the statute by including such exhaustion within the allowance made for depreciation. It would be a strained use of the term depreciation to say that, where ore is taken from a mine in the operation of the property, depreciation, as generally understood in

business circles, follows. True, the value of the mine is lessened from the partial exhaustion of the property, and, owing to its peculiar character, cannot be replaced. But in no accurate sense can such exhaustion of the body of the ore be deemed depreciation. It is equally true that there seems to be a hardship in taxing such receipts as income, without some deduction arising from the fact that the mining property is being continually reduced by the removal of the minerals. But such consideration will not justify this court in attributing to depreciation a sense which we do not believe Congress intended to give to it in the Act of 1909.

It may be admitted that a fair argument arises from equitable considerations that, owing to the nature of mining property, an allowance in assessing taxes upon income should be made for the removal of the ore deposits from time to time. Congress recognized this fact in passing the Income Tax section of the Tariff Act of 1913, § II, 38 Stat. 166, 167, when it permitted "a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business, not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year for which the computation is made;" and in the Income Tax Law of September 8, 1916, 39 Stat. 756, 769, a reasonable allowance is made in the cases of mines for depletion thereof, "not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made." These provisions were not in the Act of 1909, and, as we have said, we think that Congress, in that act, used the term "depreciation" in its ordinary and usual significance. We therefore reach the conclusion that no allowance can be made of the character contended for as an item of depreciation.

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the companies, as an exhaustion of the capital assets, and evidently the case was brought for the purpose of testing the right of the companies to deduct the royalties agreed to be paid to them upon the removal of the minerals from the lands from the sums for which they were severally assessed.

For the reasons stated, we think the Circuit Court of Appeals and the District Court erred in the judgments rendered, and the same will be reversed and the cases remanded to the District Court for further proceedings, if any are sought, upon claim of right to deduct the value of the lands, lots and stumpage sold from the assessments made.

Judgments reversed.

MR. JUSTICE MCREYNOLDS took no part in the consideration and decision of these cases.